



Chapter IV: Commitment

Criterion IV: Commitment — At A Glance

A grantmaker practicing Philanthropy at Its Best serves the public good by engaging a substantial portion of its financial assets in pursuit of its mission.

a) Pays out at least 6 percent of its assets annually in grants

b) Invests at least 25 percent of its assets in ways that support its mission

- > The purpose of the tax exemption that grantmakers enjoy is to enable them to meet their charitable goals and serve the public interest. When a foundation warehouses assets instead, it eschews its charitable purpose at the expense of taxpayers.
- > The foundation payout rate has been a frequent subject of public policy debate. The 1969 Tax Reform Act established a 6 percent payout rate; the rate was reduced to 5 percent in 1976. Since then, many foundations have adopted the legal minimum as a de facto maximum. The variable excise tax foundations pay serves as a disincentive to higher payouts.
- > Perpetual philanthropic institutions play a valuable role in sustaining the nonprofit sector and enhancing the common good, as do foundations that decide to spend down their endowments. Paying out at least 6 percent of investment assets in grants is not inconsistent with the goal of perpetuity; some grantmakers that don't have any intention to sunset already do this. These exemplary philanthropic institutions recognize that the civic sector desperately needs additional funding and that tax-exempt foundation dollars have tremendous impact when given to an effective nonprofit partner.
- > A foundation also can use its investment assets to further its mission in ways that go beyond grantmaking. Investment screens, shareholder advocacy and proactive mission investing are three means to diversify a grantmaker's portfolio in support of its mission.
- > Research demonstrates that mission investing, generally speaking, yields similar returns to traditional investing strategies. A growing number of funders are practicing mission investing, and the leaders in this field invest 25 percent or more of their assets in these ways.
- > Because data on payout and mission investing are neither centralized nor easily available, we cannot say what proportion of the nation's grantmakers meet or exceed these benchmarks. The principle undergirding this criterion is that tax-exempt assets should not be warehoused; rather, they should be deployed in support of the charitable purpose of the foundation. The key is an appropriate balance of payout and mission investing informed by the metrics established here.

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[B]y warehousing endowments, foundations defer funding today's issues for the presumed benefit of funding tomorrow's. As a result, we all face the opportunity cost of leaving today's problems unsolved, and, while we may have a difficult time calculating it, there is certainly a considerable cost in doing so.

—William M. Dietel, Former Chair
F.B. Heron Foundation³¹⁶

The purpose of the tax exemption that private foundations enjoy is to enable them to meet their charitable goals and serve the public interest. When foundations warehouse assets instead, they eschew their charitable purpose at the expense of taxpayers. Foundation perpetuity has been the central issue in discussions regarding foundation payout policies, and investment decisions traditionally have been made with a singular goal of increasing foundation assets. These approaches are shortsighted and fail to realize the significant potential of foundation assets to make positive contributions to society.

Diverse observers have commented on these issues. According to Arthur Schmidt, founder of GuideStar, the proportion of assets that are contributed as grant dollars to maintain a foundation's tax exemption is "not determined by need or opportunity; it is determined only by an arbitrary, statutory payout threshold."³¹⁷ Steven T. Miller, commissioner of the Tax Exempt and Government Entities Division of the IRS, articulated the purpose of the tax exemption granted to the U.S. civil society sector when he said that "every charity should make responsible and appropriate use of its resources to achieve its charita-

ble purposes. That is what the tax subsidy is for."³¹⁸ Researchers Akash Deep and Peter Frumkin take the concept further and assert that taxpayers are subsidizing future philanthropic giving. As they note, "When a foundation is created today, the burden of lost tax revenue is borne by citizens in the form of a tax expenditure."³¹⁹

The adoption of the legally mandated minimum level of charitable contributions as a foregone maximum results in a significant opportunity cost: it ignores pressing social needs today and diminishes institutional philanthropy's potential impact to maximize its social benefit. When an institutional grantmaker questions seriously the underlying principle that drives its payout policy, it has the potential to maintain its own strategic interests while engaging simultaneously in bold, innovative ways to maximize the social benefit of philanthropic giving. Reaching and maintaining a generous level of payout with a minimum of 6 percent dedicated to grants, ensuring that foundation assets are invested in alignment with its mission, and making investments that maximize the social value of institutional philanthropy are three steps integral to a needed paradigm shift in financial

practices that allow a foundation to make the most effective use of its assets and resources.

The total value of foundation assets obviously fluctuates over time, based on many factors. However, assets grew to \$670 billion in 2007³²⁰ and generally have shown a rapid and steady progression upwards over time. As Sarah Englehardt, then-president of the Foundation Center, stated in the press release accompanying the 2008 forecast, “Foundations are sometimes confused with individual donors in how their giving will respond to economic fluctuations. In fact, foundations—especially the larger, endowed grantmakers—often engage in long-range planning to ensure that they can maintain relatively stable levels of support for their grantees, regardless of periodic dips in their assets.” Bill Gates, co-chair and trustee of the Bill & Melinda Gates Foundation, addressed directly the impact of the current economic crisis on the foundation’s payout rate. In his first annual letter published on the foundation’s website, he stated, “During the past five years, as the foundation was

bold response that demonstrates how an exemplary grantmaker, regardless of the perpetuity issue, can and should respond to economic turmoil.

This criterion applies primarily to independent foundations, where the concern over warehousing tax-exempt dollars is greatest. Most grantmaking public charities—such as community foundations, public foundations and United Way chapters—pay out at rates well above 6 percent in grants.³²² Mission investing still is an important concept for these entities to consider, but there is less concern that a substantial portion of their assets is not being put toward a charitable purpose than with some private foundations. This chapter first addresses payout and then the ways in which foundations can serve their missions through their investment decisions.

PAYOUT

Payout has been a frequent subject of debate and continuing dialogue within the philanthropic field.

As the stock market rose and our understanding of the needs deepened, our Board voted to raise our annual payout to 10 percent, raising our program grants to about \$1.2 million per year, double the rate of most foundations. Even after the stock market turned down in the early part of this decade, we reaffirmed our commitment to our grantees by continuing to spend at the same level, thus raising our payout to about 12 percent per year. In recent years, we have realized that such a high payout is not sustainable in the current climate. We have reevaluated yearly, and continue to try to pay out between 7 and 8 percent. However, the markets are so volatile that we will likely have to continue this frequent reevaluation going forward. The challenge is always to maximize our impact on the issues we care about while still enabling us to exist in the longer term.

– Martha A. Toll, Executive Director, Butler Family Fund³²³

growing, we spent a bit over 5 percent of its assets each year in addition to the gift from Warren. There is nothing magic about the 5 percent figure, except that it is the minimum required by the IRS. Our spending in 2008 was \$3.3 billion. In 2009, instead of reducing this amount, we are choosing to increase it to \$3.8 billion, which is about 7 percent of our assets.”³²¹ Although the Gates Foundation does not seek to exist in perpetuity, this is precisely the type of

Currently, a private foundation is required to spend a minimum of 5 percent of the fair market value of its total investment assets annually.³²⁴ This includes grants made to nonprofit organizations and qualifying administrative expenses. The 5 percent minimum was established in 1976 and since then many foundations have adopted the minimum as a de facto maximum. Still, there are a sizable number of exemplary foundations, particularly newer and smaller foundations, that pay out at rates higher than the legally-mandated minimum.

Policy history regarding payout

In 1916, lawmakers and the public were concerned that private foundations were fronts for business enterprises and were shunning their charitable missions in favor of warehousing foundation assets. In response, the Walsh Commission was established fol-

lowing a congressional request to study the socio-economic influence of large foundations. The Walsh Commission proposed a ban on foundation perpetuity, but Congress did not act.³²⁵

By the early 1960s, the foundation world was growing at the rate of 1,200 new organizations annually.³²⁶ In 1964, the Senate Finance Committee asked the Department of the Treasury to investigate abuse in the field. The investigation found a relatively low level of abuse and recommended a minimum payout rate as a regulatory response to allay government and public concern. The Treasury noted in its report that the public should be able to assume that the charitable deductions foundations enjoy is being offset by the use of the funds to benefit the public good. When private foundations instead retain the funds for “indefinitely long periods,”³²⁷ the public good suffers. Congress took no legislative action.

In 1969, Sen. Russell Long (D-La.), then chairman of the Senate Finance Committee, proposed a 46 percent tax on foundation income and a ten-year time limit on foundations. In response, John D. Rockefeller III and other prominent philanthropists established the Commission on Foundations and Private Philanthropy (informally known as the Peterson Commission after its chair, Peter G. Peterson) to serve as an advocate on behalf of private foundations. The commission researched philanthropic giving in Senator Long’s hometown of New Orleans and found that the majority of foundation grants were provided to the Catholic Church, local universities and charities. The commission developed alternatives to a tax on foundations and Peterson convinced Long that imposing a high marginal tax rate on foundations would limit the funds available to help local residents, particularly lower-income residents, leading Long to advocate a minimum payout level instead.³²⁸ The Tax Reform Act of 1969 was an outcome of the commission’s findings. Congress mandated a minimum payout rate for private foundations as a result of this act.

The Tax Reform Act required private foundations to pay out whichever was greater—their entire adjusted net income or 6 percent of net investment assets. The 6 percent figure, however, was variable and linked to money rates and investment yields. Using this formula, the payout rate in 1976 would have reached 6.75 percent of total foundation assets, a level that lawmakers had not considered in 1969.³²⁹ In response, Congress eliminated some of the variability in this equation and set minimum payout at the greater of

QUALIFYING DISTRIBUTIONS AND PAYOUT

Because of the IRS’s current policy and expiration of the Deficit Reduction Act, most foundations include numerous expenses as part of their qualifying distributions, detailed in the list below. While IRS form 990 PF lists several types of allowable administrative expenses, a foundation does not necessarily count all expenses of a certain category as designated for its charitable purpose. Below is a list of allowable expenses that a foundation can count toward its qualifying distributions:

- > Compensation of officers, directors, trustees, etc.
- > Other employee salaries and wages
- > Pension plans, employee benefits
- > Legal fees
- > Accounting fees
- > Other professional fees
- > Interest
- > Taxes
- > Occupancy
- > Travel, conferences and meetings
- > Printing and publications
- > Contributions, gifts, grants paid
- > Set-asides
- > Program related investments

It also is important to note what a foundation cannot count toward its qualifying distributions. Congressional rules disallow investment expenses a foundation incurs from managing its endowment. Such fees include salaries or board meeting costs for investment management purposes; custodial fees; brokerage fees; and investment management fees. Excluding investment management fees, all foundation administrative expenses count toward payout if they are deemed “necessary and reasonable.”

entire net adjusted income or a fixed 5 percent of net investment assets.

During the debate leading up to the 1976 change, Eugene Steuerle wrote that the initial proposal in the Tax Reform Act of 1969 had been to require a flat 5 percent payout rate. The Senate rejected this rate and requested that it be 6 percent, which was included in the final law along with the provision for rate adjust-

ment. Arguments against the 6 percent rate included “invasion of corpus” and that market conditions and rates of return at the time did not support such a rate.³³⁰ Steuerle noted that “the answer to the empirical question [of the actual rate of return received by foundations] provides information by which the policy question can be addressed, but the empirical question does not determine the answer to the policy question.”³³¹ Other critics have noted that the 5 percent rule is related less to economic analysis and empirical data than to prolonged political bargaining.³³²

The Economic Recovery Act of 1981 eliminated the “greater of” provision, because requiring foundations to pay out their entire income would reduce real asset value over time.³³³ The law ended variable payout rates and since then foundations have been required to

pay out 5 percent of their investment assets. In 1984, the Deficit Reduction Act temporarily limited administrative expenses to 0.65 percent of foundation assets; this reflected a concern that a foundation practically could meet its minimum payout simply by counting its qualifying administrative expenses. The law also put the requirement that administrative expenses be “reasonable and necessary” into the statute. The 0.65 percent maximum administrative expenses requirement expired in 1990, allowing institutional grantmakers to include a range of expenses in determining their qualifying distributions.

Studies demonstrate that 5 percent is not the highest sustainable payout rate and that foundations could pay 7 or even 8 percent and maintain their endowments.³³⁴ NCRP acknowledges that some well-inten-

TABLE 4.1 MAJOR POLICY PROPOSALS ON PAYOUT

YEAR	POLICY HISTORY	RESULT
1916	Walsh Commission: Proposed ban on perpetuity	No congressional action
1964	Department of Treasury investigation	Relatively little abuse found; no legislation
1969	Sen. Russell Long proposes ten-year maximum life span and a 46 percent tax rate on private foundations	Rockefeller and other private philanthropists establish Peterson Commission to fight Long’s proposal Peterson’s findings convince Long to drop proposed tax rate and ban on perpetuity
1969	Peterson Commission findings lead to Tax Reform Act of 1969	Variable minimum payout established as the greater of: a) Entire net adjusted income or b) 6 percent of net investment assets, adjusted annually based on money rates and investment returns
1976	Minimum payout reached higher rates than anticipated	Variable minimum payout established as the greater of: a) Entire net adjusted income or b) 5 percent of net investment assets, with no variability
1981	Economic Recovery Act of 1981: Requiring foundations to pay entire net assets would erode real value of corpus over time	Minimum payout established at 5 percent of net investment assets
1984	Deficit Reduction Act of 1984: Temporarily limited administrative expenses to 0.65 percent of assets; put requirement that administrative expenses be “reasonable and necessary” into statute.	Qualifying administrative expenses limited to 0.65 percent of assets Expired in 1990 “Reasonable and necessary” requirement remains in statute
2003	Charitable Giving Act of 2003 (H.R. 7): Would require foundations to exclude administrative costs when calculating qualifying distributions.	No congressional action

tioned leaders in the sector disagree with these findings and believe honestly that 5 percent is the highest sustainable payout rate. However, NCRP and others believe higher payout and perpetuity are not mutually exclusive. Unless Congress changes the law on this issue, it is up to individual grantmakers to consider carefully their payout policies.

In the early 21st century, Congress again considered changing the statute. The Charitable Giving Act of 2003, also known as H.R. 7, included a provision that would have required private foundations to exclude operating and administrative expenses when calculating annual expenditures to meet the minimum 5 percent payout rule. According to NCRP calculations at the time, this statutory change would have represented a 0.4 percent increase in grantmaking, thereby infusing an additional \$4.3 billion annually in grant dollars into the nonprofit sector.³³⁵ The Foundation Center issued a statement in response to NCRP's claim, estimating that the actual amount would be less than half that. Yet, even using the Foundation Center's own calculations, had the increase been a more modest \$2 billion, it still would have represented a 17 percent increase in foundation giving to nonprofits.³³⁶ Although the Senate passed the companion bill, the CARE Act (S. 476), Congress did not act on the payout rule prior to the close of session and there was no change to the current statute.

Payout has been the focus of foundation-related policy discussions for nearly 100 years. Table 4.1 summarizes major policy proposals related to payout, the rationale behind each and the outcome of the proposal.

Studies of foundation payout: influencing factors, contrasting viewpoints

While there appears to be strong convergence around the 5 percent minimum as a foregone maximum among many foundations, there is a movement in the sector by some individual foundations to link payout with mission achievement, often resulting in payout rates significantly higher than the minimum.³³⁷ But the aggregation of payout data that frequently include spend-down foundations, grantmaking institutions with living donors and operating foundations along with private foundations often leads to the perception of a higher rate of grants paid out than actually is true. In other words, the higher payout rates maintained by the many types of foundations aggregated in most payout analyses suggests higher than actual payout rates maintained by most private foundations. For

example, a recent article highlights the limitations of perpetuity and the assumption of the 5 percent as a foregone maximum payout rate. In raising pertinent issues for any grantmaker to consider when discussing issues of perpetuity and mission, Arthur Schmidt suggests maximizing the social value of philanthropy as an alternate core guiding principle for this issue.³³⁸ This analysis also notes that once qualifying distribution expenses are accounted for in payout, the average foundation pays out 4 percent in grants.

Three studies that analyzed actual foundation payout data resulted in somewhat contradictory findings. Deep and Frumkin examined the average payout rates and total return on investment for 169 foundations from 1972 to 1996. They found strong convergence around 5 percent payout as a de facto maximum; the sample averaged 4.97 percent payout, despite an average annual return on foundation investment assets of 7.62 percent. Similarly, Cambridge Associates found that in a sample of 33 Michigan foundations, the payout rate was 4.86 percent from 1982–1997. This further illustrates the convergence around the 5 percent minimum as a predetermined maximum following the institution of the statute. Richard Sansing and Robert Yetman's sample comprised 4,239 individual foundations—representing nearly 60 percent of all foundation assets—and focused on the bull market period of 1994–1998. They found that their sample paid out an average of 6.45 percent of investment assets annually, while the assets of foundations in their sample grew at about 17 percent per year.

DeMarche & Associates analyzed investment returns for a hypothetical foundation and concluded that 5 percent may be too high a payout rate for a foundation to exist in perpetuity.³³⁹ Cambridge Associates also concluded that their findings supported a maximum 5 percent payout. These findings merit some robust debate and frank criticism. Foundation growth during the years in which the DeMarche study was conducted was so robust that the researchers acknowledged that foundations could have increased their payout rates to 6.5 percent with minimal to no impact on their corpuses. Moreover, when Perry Mehrling³⁴⁰ applied his own methodology to DeMarche's hypothetical foundation, he found that over the course of 20 years a payout rate as high as 8 percent would have maintained the foundation's asset size. Yet, DeMarche & Associates insisted that 5 percent was the maximum sustainable payout rate for any foundation seeking to exist in perpetuity.

The studies above focused on determining an appropriate level of foundation payout based on investment returns and existing payout habits. Paul Jansen and David Katz³⁴¹ applied an investment concept known as discounting to show that foregoing work on current social problems in favor of storing wealth for future grants is a bad investment strategy for foundations and reduces the value of the original tax-deductible donation. They calculated the present value of future grant investment returns by discounting the returns at a certain rate. From the resulting data, they argued that by paying out at just 5 percent, foundations are foregoing contributing more today and assuming future social problems will be more compelling, but that this is an insufficient justification for low payout rates.

As Mehrling and others have pointed out, treating the legal minimum as a maximum makes it appear that many foundations are doing exactly what Congress wanted to prevent when establishing the minimum—warehousing wealth in perpetuity, thereby defeating “the real social purpose of their privileged tax status.”³⁴² Deep and Frumkin interviewed foundation leaders to understand why more foundations do not pay out at rates higher than 5 percent. Their findings identified three obstacles to payout differentiation:

1. Managerial constraints within staff and board, such as the difficulty of quantifying return on social investment compared with that of the investment portfolio;
2. Conceptual obstacles, such as difficulty of calculating current social benefits versus future social benefits; and
3. Current tax treatment of investment income (the excise tax structure).

More recently, Schmidt highlighted three barriers implicit in the current perpetuity paradigm as limiting institutional philanthropy’s social value and strategic potential:

1. Immunity from market and public pressures for accountability;
2. Diminished ability to engage foundation resources, fiscal and human, for optimal resource deployment; and
3. Negative impact on the real social value of institutional philanthropy’s assets, resulting in social costs to the charitable sector and society at large.³⁴³

An important corollary to the third barrier noted above is that it not only has negative consequences for addressing social needs today but also increases the future social costs for when philanthropy does turn its attention to those problems.³⁴⁴ As Schmidt states, “Any nominal appreciation in the value of a perpetual endowment must be discounted significantly by the cost society incurs (a *social cost of capital*) from the human suffering, environmental degradation and other problems left unresolved today.”³⁴⁵

In 1999, during the National Network of Grantmakers’ (NNG) “1 Percent for Democracy” campaign, NNG asked its members and all other foundations to increase grants payout by 1 percent. NNG found that nearly 83 percent of its 400 individual members agreed that payout should increase, but only a small majority believed that their foundation leadership would support such a change.³⁴⁶ This, combined with the first barrier identified by Deep and Frumkin, suggests the need for open dialogue within individual foundations and across the foundation world to address the ways in which payout policy affects mission achievement and affects the bottom line of philanthropy: *impact*.

The foundation excise tax: a disincentive to increasing payout

A persistent and salient policy issue related to payout is the foundation excise tax. Foundations largely are exempt from taxation but they are required to pay certain taxes, including an excise tax on investment income. The current structure of the excise tax is two-tiered: the tax rate is 1 percent but rises to 2 percent for five years if the foundation distributes less in one year than the average of the preceding five years. Two researchers clarify the consequences of this structure with an example: “Suppose over the preceding five years, the foundation spent on average 6 percent of its investment assets in qualifying distributions. This year the foundation has investment assets of \$100 million and net investment income of \$8 million. If this year’s qualifying distributions are less than \$6,080,000, then the excise tax is \$160,000; if qualifying distributions are \$6,080,000 or more, then its tax is \$80,000.”³⁴⁷ In other words, should a foundation wish to temporarily pay out at a higher rate, the foundation can expect to pay more excise tax if it reduces its payout in future years. The variable excise tax thus serves as a disincentive for a foundation to increase its payout rate.

Advocates of retaining the excise tax have requested that it be used for its original purpose: to fund IRS oversight of the charitable sector and data services.³⁴⁸ Others argued that because the excise tax is both a disincentive for varying payout rate and is not being used for its original intent, it should be eliminated.³⁴⁹ Audit coverage of the sector is historically low, despite the fact that the income from the excise tax—estimated at \$500 million annually³⁵⁰—far exceeds the budget of the IRS Exempt Organizations Division. The money is diverted to the general treasury, and the remaining funding is not sufficient for the IRS to perform its enforcement duties.³⁵¹ The Council on Foundations, NCRP, Independent Sector and the Aspen Institute Nonprofit Sector and Philanthropy Program all have urged Congress to make fixing the excise tax structure a legislative priority.³⁵²

Decision-making factors for payout: Perpetuity, spend-down and mission

Often, it is the donor's intent to provide a lasting social benefit to the communal social problems, which are interconnected, structural, complicated and impossible to solve in a lifetime. Thus, many contend that a foundation should be prepared to work toward its mission in perpetuity.³⁵³ Additionally, some argue that professional foundations add value in their grantmaking through their expertise, which makes them more efficient and effective grantmakers than foundations that exist for a relatively short period of time.³⁵⁴ NCRP recognizes the value of perpetual foundations to civil society and our nation as a whole.

A large number of foundations, however, are choosing to spend down their endowments in lieu of perpetuity. Julius Rosenwald, the former president of Sears, Roebuck & Co., was one of the first philanthropists to question the assumption of foundation perpetuity implicit in much of the sector. He wrote that the goal of perpetuity for private foundations indicated a lack of confidence in the future, and he had absolute confidence in future genera-

tions to meet their own needs. In 1948, nine years before the deadline Rosenwald had imposed, his foundation closed its doors.³⁵⁵ While the decision to spend down is not unique, the issue of payout and the adoption of 5 percent as a maximum rather than its intended minimum is one that continues to spark dialogue.

While the decision to spend down is not unique, the issue of payout and the adoption of 5 percent as a maximum rather than its intended minimum is one that continues to spark dialogue. ... [T]radition and a lack of consensus in the foundation world are strong barriers to changes in payout policy.

As discussed above, tradition and a lack of consensus in the foundation world are strong barriers to changes in payout policy. In a 2004 discussion of payout moderated by Michael Klausner, many foundation leaders emphasized the importance of matching payout to mission. John Healy, formerly of The Atlantic Philanthropies, criticized foundations for taking perpetuity as “an article of faith,” adding that The Atlantic Philanthropies’ mission “implies a sense of urgency which compels us to spend down rather than seek perpetuity.”³⁵⁶ Others noted that when the donor establishes the foundation with the intent of contributing to society perpetually, the foundation is compelled to adopt a lower payout rate. Additionally, long-term problems lead a foundation to seek perpetuity in order to provide lasting support for organizations working to solve those problems.

Tying foundation mission explicitly with payout policy appears to be increasing across the sector. Spending down seem to be growing as thousands of new foundations are formed annually. The Bill and Melinda Gates Foundation, with its massive endowment, has committed to sunset within 50 years of the death of its last founding trustee.³⁵⁷ The Gates Foundation's grantmaking accounts for about one in every ten philanthropic dollars.³⁵⁸ The John M. Olin Foundation was established in 1953 by John M. Olin, president of the Olin industries, a chemical and munitions manufacturing corporation. Olin committed to spending down his foundation during his lifetime; the

Olin Foundation made its last grant in 2005. These examples demonstrate that spending down is a valid option for a foundation to consider when linking payout policy with its mission.

In *Beyond 5 Percent*, Heidi Waleson examined 13 foundations that pay out above the federal minimum; she termed 5 percent payout policies “traditional” foundation practice.³⁵⁹ Many foundations featured in the report have chosen to spend down in the name of mission and in accordance with donor

It makes no sense to use 5 percent of your assets to try to promote something, while the other 95 percent might be doing something totally contrary. We try to use 100 percent of our assets to promote our values.

– Victor De Luca, President, Jessie Smith Noyes Foundation³⁶²

intent, granting between \$200 million and \$800 million within a few decades. The Lewis B. and Dorothy Cullman Foundation, for example, is committed to ceasing operations within one year of the founder’s death. Cullman established his foundation believing that it should benefit society in his lifetime and that future generations would step up to address future social problems. As he put it, “I don’t care what people say about me when I’m dead. I won’t be around to hear it. Why not get the joy out of spending your money while you’re alive?”³⁶⁰ The Lewis B. and Dorothy Cullman Foundation paid out more than 30 percent of its non-charitable use assets in 2006. Also featured in Waleson’s report, the Whitaker Foundation made the decision in 1991 to help start and grow university biomedical engineering departments, spending more than \$800 million on achieving its mission and closing down in 2006. This infusion of funding is credited with jump starting the field of biomedical engineering, which now has 80 university departments across the country.³⁶¹ This example seems to supersede some of the arguments for preserving foundation assets to address future problems. Many of the foundations in the study enjoyed greater flexibility in spending and financial management when they focused on mission achievement rather than perpetuity.

MISSION INVESTING

Mission investing (MI) is an effective way for foundations to leverage their non-grantmaking assets to serve their own missions and benefit society. In this criterion, MI is the term used to denote all aspects of a comprehensive mission investment strategy: investment screening, shareholder advocacy and proxy voting, and proactive mission investments. This section reviews how foundations can leverage their endowments and power best as shareholders to achieve their

missions and maximize their contributions to the greater public good.

At the F.B. Heron Foundation, which currently is investing 26 percent³⁶³ of its assets in mission investments (MIs), the guiding question that the board adopted when it began developing its MI program was, “Should a

private foundation be more than a private investment company that uses some of its excess cash flow for charitable purposes?”³⁶⁴

History of mission investing

The origins of modern socially responsible investing and shareholder activism can be traced back to the early 1970s. The first mutual fund to screen for social issues was started by a group of Methodist clergy in 1971, prior to the Episcopal Church’s divestment work in South Africa. In 1973, the South Shore Bank, now ShoreBank, became the United States’ first private development bank. ShoreBank was created to demonstrate the important role that a regulated bank could play in revitalizing communities marginalized by other financial institutions. It was located in a neighborhood on the south side of Chicago that was dealing with race and class tensions at the time. Today, ShoreBank is an internationally-recognized socially responsible investor. It operates in multiple U.S. cities and internationally and its mission states that it “invests in people and their communities to create economic equity and a healthy environment.” The Episcopal Church used shareholder resolutions in the 1970s to pressure companies with business in South Africa during Apartheid to cease operations there.³⁶⁵

Shareholder activism through resolutions and proxy voting long has been the realm of pension funds since the ERISA (Employee Retirement Income Security Act) Act of 1974 cited proxy voting and the monitoring of non-financial information as part of good management.³⁶⁶

During the 1980s, social investment grew rapidly in the wake of insider trading and environmental degradation scandals. In 1985, the Social Investment Forum documented \$40 billion in professionally managed investments with social criteria; by 1991, that figure had grown to an estimated \$625 billion.³⁶⁷ Organizations pressured by the Episcopal Church disinvested in South Africa's companies to demonstrate their values through their investment decisions. Socially responsible investing (SRI) is rooted in a moral concern for the way in which pools of capital are invested and often is described as investing with a "double bottom line."³⁶⁸ The Social Investment Forum Foundation defines the double bottom line as "[a]n investment seeking financial and social returns."³⁶⁹

Foundations and mission investing

As with SRI,³⁷⁰ mission investing seeks a double bottom line. In the case of institutional philanthropy, a grantmaker demonstrates its commitment by leveraging its investment assets to achieve its mission using MI. Screening, shareholder advocacy and proactive mission-investing may be used together or alone. For example, screening investments is a simple first step that all foundations easily can take. The three strategies of comprehensive mission-investing in exemplary philanthropy are:

1. *Screens*: Screening traditional investments for social or environmental factors can help a foundation seek corporations whose practices do not conflict with its mission. Screens can be either positive or negative; that is, a screen either can seek out a certain trait such as paying employees a living wage or it can avoid a certain trait such as companies that produce tobacco products.
2. *Shareholder advocacy*: Foundations can leverage stock portfolios to introduce shareholder resolutions and to vote proxies. Foundations also can involve their grantees when appropriate to improve corporate practices.
3. *Proactive mission investing*: Proactively seeking out investment opportunities that advance a foundation's mission such as investing in affordable

housing and providing direct loans to nonprofit organizations.³⁷¹

There is a lack of robust data regarding the extent to which foundations engage in mission investing. However, FSG Social Impact Advisors conducted a study that examined 92 foundations to analyze MI among foundations. In *Compounding Impact: Mission Investing by U.S. Foundations*, Kramer and Cooch defined "mission investing" as "financial investments made with the intention of (1) furthering a foundation's mission and (2) recovering the principal invested or earning financial returns."³⁷² Mission investments were grouped into two main categories:

1. *Market-rate mission investments*: Investments that account for social and environmental considerations in which a foundation seeks financial returns comparable to average risk-adjusted returns of investments made without regard for such concerns.
2. *Below market-rate mission investments*: Foundation asset investments that seek financial returns below the risk-adjusted average returns. A foundation invests its assets in this way when the goal of the investment cannot be realized using market-rate investments or when it opts to use its non-grant-making funds for charitable objectives over earning a profit. Private foundations also may claim mission-related investments such as program related investments (PRIs),³⁷³ which count for qualifying distributions.³⁷⁴

The study found that only 2.6 percent of private foundation assets were allocated to mission investments. The authors contend that despite the lack of robust data and reporting on mission investing in the foundation sector, their findings are indicative of sector-wide trends in this practice. This is partly because the subsample that provided investment details represents 12 percent of all U.S. foundation assets; the subsample that participated in qualitative interviews accounts for 20 percent of foundation assets.³⁷⁵ However, the study selected foundations that were known to engage in PRI and MI or otherwise recommended it. Complementing this study with preliminary data from a Council on Foundations survey, which found that over 82 percent of foundations "do not take social, environmental or other nonfinancial factors into account when managing ... financial

A PROMINENT GRANTMAKER ADDS NEW MOMENTUM TO FOUNDATION MISSION INVESTING

The W.K. Kellogg Foundation had a \$9 billion endowment in 2008 and devoted \$100 million to mission investments in the United States and Africa. In Kellogg's case, the development of a mission investment team, comprising program and investment staff, occurred quickly following initial board conversations in January 2007. Three months later, the board agreed to the \$100 million allocation, after the team found ample opportunities for mission investments in multiple asset classes. One staff member said, "Few ideas have resonated more completely or more quickly than helping to closely connect investments to our mission."³⁹¹

assets,"³⁷⁶ suggests that a majority of foundations do not account for mission in their investment decisions. In light of this, the relevant question for exemplary philanthropy is *why* so few foundations match investment strategy with mission.

A significant barrier to higher levels of philanthropic engagement in MI is the perception that only larger foundations have the human and financial capacity to align investments with mission. However, the FSG Social Impact Advisors study referenced above also found that 30 percent of all private foundations making mission investments had total assets of less than \$50 million and 9 percent had less than \$10 million in assets. Further, smaller foundations comprised 44 percent of all new mission investment dollars in 2005.³⁷⁷ Mission investment intermediaries can help foundations with little or no staff to develop the expertise and capacity to engage in MI.

Some foundation leaders may view MI as financially riskier and as providing below-market returns. However, data from individual foundations and from the Community Development Fund Index dispel this perception. The Fund Index publishes data annually on the aggregate accomplishments of its funds, which provide financial services to traditionally underserved populations—70 percent of Community Development Financial Institutions (CDFI) clients were lower income in FY 2006.³⁷⁸ Grantmakers can invest in Community Development Venture Capital funds

(CDVCs) through CDFIs as part of a mission investing program. The CDFI Data Project found that CDVCs had a gross internal rate of return of 15.5 percent in FY 2006. By comparison, the 12-month total return for the S&P 500 in December 2006 was 15.79 percent.³⁷⁹ Further, Cooch and Kramer analyzed returns on MI loans for foundations in their study. They found that 75 percent of the 28 foundations able to provide data on their loan mission investments had a zero default rate. When three outliers, foundations with high default rates, were removed, this figure jumped to 96 percent.³⁸⁰

Individual foundations have shared their success in MI as a way to encourage their peers to follow suit. In 2003, the F.B. Heron Foundation, which allocated 19 percent of its assets to mission investments that year, achieved a total return on investment of 21.07 percent, which was at or above the median rate of return for traditional investments made by foundations.³⁸¹ In December 2003, the S&P 500 posted a 12-month return of 28.69 percent.³⁸² By 2006, the F.B. Heron Foundation had allocated 24 percent of its assets to MI³⁸³ and began aggressively encouraging peers to adopt an MI strategy. It also pioneered the Community Investment Index, a positively screened investment fund with companies that support lower-income communities through workforce development, wealth creation and corporate philanthropy.

In April 2007, the F.B. Heron Foundation partnered with the Annie E. Casey Foundation, the Meyer Memorial Trust Foundation and Cambridge Associates, a reputable independent investment advisor, to launch the "More for Mission Campaign."³⁸⁴ This campaign challenges foundations to allocate, in the aggregate, 2 percent of their assets for mission investments that would generate some \$12 billion more in foundation financial commitments by aligning mission with investing practice. The "More for Mission Campaign" also seeks to build the funder knowledge base of mission investing; to generate a network of foundations committed to mission investing; and to contribute robustly to the knowledge base for investors to leverage their non-grantmaking assets in support of mission.³⁸⁵ Cambridge Associates formed the Mission Investing Group with the support of these three foundations to provide technical assistance to institutions initiating an investment strategy that aligns with mission. As the F.B. Heron Foundation's president Sharon B. King states, "Harnessing the power of the capital markets for pos-

itive social and environmental impact is essential. It is appropriate that tax-advantaged institutions, such as foundations and endowments, begin to invest for mission in a thoughtful and rigorous way.”³⁸⁶ Indeed, the F.B. Heron Foundation’s current goal is to increase its mission-related investments to 50 percent of its assets by the end of 2010.³⁸⁷

The case for increased mission investing

The barriers to mission investing are similar to those for increased payout: a lack of motivation at the individual foundation level and a knowledge gap related to the tools needed to implement a mission investing program. Lance Lindblom, president and CEO of The Nathan Cummings Foundation, identifies lack of integration and communication within foundations as a barrier. “The practice in foundations has typically been for the program areas to focus on mission and the investment committee to focus on financial returns, with little—if any—awareness between these silos. And yet, social and economic justice requires an integrated society. Corporations and business cannot be separated from concerns about health, the environment, the arts, about how we live our lives.”³⁸⁸

Some foundation leadership may not be open to mission investing; this stems primarily from concerns about fiduciary responsibility. Highly risk-averse,

directors often are too content to adhere strictly to a “prudent man” approach, which dates back to Harvard University in the 1800s. This approach said that trustees of a foundation or endowment should act as a “prudent man,” now a “prudent investor,” would when investing his or her own funds.³⁸⁹ The assumptions implicit in this behavior are reductionist: they presume that a trustee is a rational economic actor with full access to comprehensive knowledge about the entire universe of investment options available to institutional grantmakers. Moreover, unlike the “prudent man,” exemplary institutional philanthropy seeks a double bottom line return, financial and social. At a minimum, a foundation is obliged to carry out its stated mission in addition to a social mission that aligns with or supersedes its assessment of financial returns from its investment strategies.

The Uniform Management of Institutional Funds Act of 1972 acknowledged that some risk is unavoidable in any investments. Risk tolerance is both necessary and acceptable so long as the risk does not put the endowment as a whole in jeopardy. The argument that mission investing is too risky does not stand when one considers that foundations have invested in other unconventional stocks such as hedge funds, private equity, international stocks and natural resources.³⁹⁰ When there is open communication among board and staff leadership, grantmak-

THE IMPACT OF PROXY RESOLUTIONS

Sometimes, investment managers within foundations may notice discrepancies or conflicts of interest between program goals and investment decisions. In 2002, Caroline L. Williams, chief financial and investment officer for the Nathan Cummings Foundation, noticed that the foundation had given sizable grants to organizations working to hold big agribusiness environmentally accountable, focused on the hog industry. At the same time, the foundation held over \$700,000 in shares of Smithfield Foods, the world’s largest hog producer and

pork processor with an abysmal environmental record. In response, Williams worked with Cummings Foundation president and CEO Lance Lindblom to request a shareholder resolution requiring Smithfield Foods management prepare a report describing the environmental, economic and social impacts of its operations.³⁹² The Cummings Foundation was joined by Amalgamated Bank and the Sierra Club in issuing a proxy statement asking Smithfield for a report to measure company compliance with the Global Reporting Initiative

Sustainability Reporting Guidelines. Because the Securities and Exchange Commission ruled that Smithfield could exclude the resolution from the proxy vote, it did not produce the report, citing the rigid nature of the guidelines.³⁹³ Yet, the proxy had significant impact on Smithfield’s voluntary adoption of many elements of the guidelines and increased transparency as evidenced by its production of the 2003 and 2004 Stewardship Reports, and the 2005 and 2007 Corporate Social Responsibility Reports.³⁹⁴

ers have found success engaging in MI *and* fulfilling their fiduciary responsibilities.

Although some foundations identify risk-aversion as a reason not to engage substantively in MI, if a foundation does not screen its investments, it runs the risk of public embarrassment should discrepancies like the Cummings example not be dealt with transparently. In 2007, the *Los Angeles Times* investigated the investment practices of the Bill and Melinda Gates Foundation and found that it had large investments that ran contrary to the foundation's global health efforts.³⁹⁵ Examples of undermining the foundation's long-term goals for short-term financial gain included significant investments in pharmaceutical companies that kept the price of antiretroviral drugs prohibitively high for patients in the developing world where the foundation does much of its AIDS work, and major polluters in developing countries such as oil companies that contributed to health problems among local populations. The Bill and Melinda Gates Foundation owns more than \$450 million in stocks in pharmaceutical companies that are considering shareholder resolutions to increase the availability of antiretroviral drugs in less-developed countries.³⁹⁶ Despite the negative consequences for the foundation's public image from these conflicts of interests, a senior policy officer at the foundation stated that the foundation does not believe it should involve itself in proxy voting because "we want people to understand that the people at the foundation are trying to figure out how to help the people in our areas of focus, and we don't spend our time thinking about the investment portfolio."³⁹⁷ The Gates Foundation holds its investment assets in the Bill and Melinda Gates Foundation Trust, a separate entity from the Bill and Melinda Gates Foundation.

Discrepancies between a foundation's stated mission and its fiduciary choices raise pertinent issues regarding whether or not it is investing in socially responsible manner that accounts for social and public needs, not only short-term financial gains for an individual endowment. In short, conflicts of interest created by investment strategies negatively impact the social benefit of philanthropy's capital to enhance the common good today and in the future. As Arthur Schmidt notes, "Despite all the good work that foundations do, their perpetuity-at-all-costs mindset ensures that their endowments will constitute a depleting social asset."³⁹⁸ An exemplary foundation that engages in substantive mission investing is more likely to preserve the social value of its endowment in

the long term than one that fails to account for the "social cost of capital" in linking this investing strategy with its decision to continue in perpetuity.³⁹⁹

In addition to screening investments, a foundation can establish proxy voting policies rather than automatically voting with management. Foundation leadership may be concerned that voting against management will lead to lower returns.⁴⁰⁰ However, studies show the results of shareholder resolutions and engaged proxy voting: honest and reasonably compensated corporate management, socially responsible corporations and independent boards of directors lead to stronger financial returns.⁴⁰¹

Some grantmakers may think that shareholder resolutions are ineffective. However, a resolution does not have to gain a majority vote to prompt management to act. Modest minority shareholder votes are responsible for such changes in corporate practice as curbing predatory lending, adopting Coalition for Environmentally Responsible Economies (CERES) environmental principles and increasing recycling rates.⁴⁰² A survey by the *Chronicle of Philanthropy* found that more than 25 percent of the largest private foundations have integrated environmental or social screening in their investment strategies.⁴⁰³ Many foundation leaders surveyed by the *Chronicle* stated that they used money managers as delegates for their proxy voting decisions, citing lack of human and financial resources at their foundations to take on this task.⁴⁰⁴ In contrast, Victor De Luca, president of the Jessie Smith Noyes Foundation told the *Chronicle* that Noyes employees had reviewed close to 120 shareholder proxy statements in 2005, with De Luca making the final decisions and casting the votes himself.⁴⁰⁵ More recently, Noyes reported voting proxies in two portfolios that comprise close to 25 percent of the foundation's investments. In 2008, Noyes voted its proxies with close to 300 companies.⁴⁰⁶

The Educational Foundation of America (EFA) began using negative screens in 1994 and launched a shareholder activism campaign in 1999 to speed Home Depot's phase-out of old growth timber sales. EFA filed the shareholder initiative, which had an impact despite winning only 11 percent of shareholders' votes,⁴⁰⁷ while providing support to environmental nonprofits such as the Rainforest Action Network. This dual approach—working from within as an investor and providing support to groups putting external pressure on Home Depot—led to speedier implementation of the no old-growth policy.⁴⁰⁸

Often, foundations lack the internal capacity to manage investments, and hire professional firms instead. In such cases, it is imperative that foundation leadership work with the investment manager and foundation program staff to ensure that the foundation's proxy voting policy is followed and to integrate mission goals into investment strategy. Mission investment intermediaries are one way in which foundations with limited capacity can build a mission investing program. The most common intermediaries are CDFIs, as discussed earlier. In 2005, they achieved substantive measurable impact, all while providing a return to investors. They financed businesses that created or sustained nearly 40,000 jobs; facilitated the creation or renovation of more than 55,000 units of affordable housing; provided more than 11,000 alternatives to payday loans; and helped establish 138,045 first-time bank accounts for lower-income individuals.⁴⁰⁹

Over the past decade, the number of foundations with mission investments has doubled and annual funds invested have tripled.⁴¹¹ As mission investing expanded beyond the traditional PRI investors, including the Ford Foundation, the David and Lucile Packard Foundation and the John D. and Catherine T. MacArthur Foundation, led in large part by newer foundations such as the F.B. Heron Foundation, others have followed. Moreover, just as socially responsible investing is growing in the business world, current philanthropic interest in raising awareness of an institution's investment decisions on environmental and social impact issues resonates with foundations whose missions seek to improve community-wide benefits and outcomes.

An integrated approach to mission investing incorporates all three strategies: screened investments, shareholder activism and proxy voting, and proactive mission investments. To incorporate MI comprehensively as part of a foundation's investment strategy, a foundation should develop board-level understanding, include investment and program staff, involve grantees in shareholder activism, and enlist experts such as mission investment intermediaries to identify opportunities.⁴¹² As Luther M. Ragin Jr., vice president of investments for the F.B. Heron Foundation, put it, "The approach is not without risk. But if taking well-considered risks for public benefit is not the role of philanthropy, then what is?"⁴¹³

The Needmor Fund, a family foundation with an endowment of close to \$30 million at the end of

LEVERAGING NON-INVESTMENT ASSETS— PUBLIC BENEFIT

In 2001, the Public Welfare Foundation in Washington, D.C., relocated to the Shaw neighborhood, donated space to Manna Community Development Corporation and created meeting spaces for nonprofit organizations. The foundation then partnered with Manna to finance affordable housing construction in the neighborhood. Relocating offices to blighted communities and providing office spaces to grantees are examples of leveraging non-grantmaking, non-investment assets to advance foundation mission and enhancing the public benefit of philanthropy.⁴¹⁰

2007, first began screening investments in the 1980s when the board raised the issue of investments in companies doing business in South Africa during Apartheid.⁴¹⁴ The Fund provides one example of an integrated approach to foundation MI. Needmor now screens 100 percent of its investment portfolio. In 2000, the foundation—which funds exclusively community organizing groups—collaborated with grantees to introduce resolutions that supported grantees' campaigns directly. The fund also has a strong community development investment program, which has financed homes, provided microloans to impoverished families, developed small businesses, created jobs and financed the construction of community facilities.⁴¹⁵ In 2007, Needmor had 14 percent of its assets invested in market-rate community development programs. Needmor's mission-related investing has grown to incorporate all three MI strategies.

While several exemplary foundations are both making efforts to incorporate mission achievement into asset management and also providing resources to foundations interested in mission investing, mission investing persists as a significant lost opportunity for foundations to enhance their impact. The tools to leverage assets beyond grantmaking, such as market-rate MI, mission investment intermediaries, and engaging in shareholder activism, all are readily available to institutional grantmakers. These are essential components of foundations ensuring that they are doing all they can to meet their missions.

SETTING THE BAR FOR PHILANTHROPY AT ITS BEST

Most foundations use only a tiny fraction of the financial assets at their disposal to achieve their missions. As this chapter demonstrated, most foundations continue “traditional policies” of paying out only 5 percent of their assets in grants and qualifying distributions each year and do not prioritize the potential mission-advancing power of their investment assets in non-grantmaking ways. Consequently, a significant opportunity for broad, long-term changes and advancing a foundation’s mission is lost. Foundations should dedicate substantial portions of their endowments towards achieving their charitable purposes.

By adopting 5 percent as the de facto maximum payout rate, a grantmaker foregoes an opportunity to increase its impact and demonstrate its commitment to using its tax-exempt dollars for a true charitable purpose. Because civil society sector grantees are the means to deliver institutional philanthropy’s benefit to the public, the focus should be on how much a funder distributes in grants. Different types and sizes of grantmaking institutions have variable administrative needs, and foundations should be free to cover their administrative costs in whatever manner is most appropriate. But the public interest is served best by focusing attention on how much is paid out in grants. Providing 6 percent of its assets as grants to its non-profit partners is a reasonable and fair benchmark. Indeed, the following data analysis shows why NCRP chose to focus the metric for this criterion to the percentage of a foundation’s assets that are paid out in grants and not on overall payout rates.

By maintaining a generous payout level with 6 percent allocated to grants, an exemplary foundation working within the framework of *Philanthropy at Its Best* also adds more monies for the civil society sector. Recent commentary and surveys have revealed that while individual foundation staff members often support increased payout, foundation leadership and trustees are not always open to discussing payout in a meaningful way.⁴¹⁶ Foundations that are serious about mission achievement should engage staff, leadership and board members in dialogue regarding payout policy.

In 2008, the Urban Institute’s Center on Nonprofits and Philanthropy, the Foundation Center and GuideStar released the final results of the Foundation Expenses and Compensation Project, “the first large-scale, long-term, systematic study of independent,

corporate, and community foundations’ expense and compensation patterns and the factors behind them.”⁴¹⁷ The study analyzed data from the 10,000 largest U.S. grantmaking institutions between 2001 and 2003 and provides a rigorous analysis of various elements of the foundation world’s finances, including a range of financial measures that impact foundation expenses such as staffing levels and trustee compensation. In the aggregate, total giving⁴¹⁸ by independent foundations from 2001–2003 comprised \$18.3 billion; total independent foundation assets were \$312.4 billion. The total number of independent foundations in the study was 8,876.⁴¹⁹ Thus, the aggregate amount of grants provided in the study’s timeframe was 5.86 percent of assets. Because these aggregate statistics include spend-down foundations and foundations with living donors, the numbers must be interpreted with caution. Yet, coupled with the study’s findings that 29 percent of the 10,000 foundations studied employ staff, which affects charitable administrative expense to qualifying distribution ratios, these findings suggest that many grantmaking institutions in fact pay out at higher levels than the legally mandated minimum 5 percent. However, the study also identified staff employment followed by staff size as the most important variables affecting independent foundation expense levels.⁴²⁰ This suggests that while a large number of independent foundations pay out grants at rates higher than 5 percent, many such grantmaking institutions likely do not.

An analysis of total grants made and total assets from 2000 to 2005 in the 2008 edition of *The Nonprofit Almanac* provides similar data on grants paid out by independent foundations. Table 4.2 summarizes aggregate total giving for independent foundations.⁴²¹

The data from 2001 to 2003 are especially important because these are years during which the economy was in a recession. Despite the negative impact on foundation asset bases, there was marginal impact on the proportion of grant dollars distributed. Moreover, this timeframe shows a higher level of grant dollars paid out in grants compared to 2000, prior to the impact of the recession. Taken together with the Foundation Center’s forecasting for 2008 giving referenced earlier, this suggests that the majority of foundations do, in fact, use long-range planning in determining their payout. Most foundations use a three-year timeframe in determining what level of payout to maintain.

A closer look at the largest independent foundations, those with assets of \$10 million or more in 2002–2004, provides some balance to the overall sector trends. These data are summarized in Table 4.3.⁴²²

The percentage of grants made by the largest independent foundations included in the *Almanac* is disappointingly low. Although such foundations represent 0.3 percent of all foundations analyzed, their assets accounted for 48.4 percent of all independent foundation assets in 2004 and 49.9 percent in both 2003 and 2004. These data indicate that the largest independent foundations are paying out well below 5 percent of their enormous assets in grants. The only year in which this subsample provided more than 5 percent of its total assets in grants was 2002; in 2003 and 2004, the numbers in the table above are similar and below 5 percent.

TABLE 4.2 AGGREGATE TOTAL GIVING FOR INDEPENDENT FOUNDATIONS, 2000–2005

YEAR	GRANTS MADE IN \$ MILLIONS	ASSETS IN \$ MILLIONS	PERCENTAGE TOTAL GIVING
2000	21,346	408,749	5.22
2001	23,705	403,526	5.87
2002	23,254	364,143	6.39
2003	22,568	399,138	5.65
2004	23,334	425,103	5.49
2005	25,199	455,570	5.53

To contextualize foundation grants paid out better, it is worth noting the amount of total giving to foundations as noted in the 2008 edition of *Giving U.S.A.* The data are drawn from 2006 and total estimated giving to foundations, excluding the Buffett payments to the Gates Foundation, was \$27.73 billion.⁴²³ Comparing this figure to the amount of giving by foundations for grants in the *Almanac* noted above leads to serious considerations of whether or not the social benefit of philanthropy is being diminished in favor of warehousing foundation assets for the goal of perpetuity. Contrasting giving to foundations with giving by foundations noted by the Foundation Center lends more credence to the argument that philanthropy's perpetuity doctrine is undermining its social potential. Estimated giving by foundations in 2007 was \$42.9 billion,⁴²⁴ less than double the amount of gifts received by institutional grantmakers. To reiterate, NCRP acknowledges the value of perpetual foundations in sustaining the U.S. civil society sector. Yet, the preceding data analysis demonstrates that higher payout rates and perpetuity are in no way mutually exclusive.

Warehousing of partially public dollars does not serve the public interest or advance the social benefits of philanthropy. In light of the data presented in the two studies above, it is clear that many foundations can and do have an all-grants payout rate of more than 5 percent. An exemplary foundation should focus on applying its assets toward fulfilling its mission and using its tax subsidized partially public

TABLE 4.3 AGGREGATE TOTAL GIVING OF FOUNDATIONS WITH ASSETS OF \$10 MILLION OR MORE, 2002-2004

YEAR	ASSETS IN MILLIONS	GRANTS MADE IN \$ THOUSANDS	ASSETS IN \$ THOUSANDS	PERCENTAGE GRANTS MADE
2002	250 or more	10,591,925	210,772,484	5.03
	50–249.9	5,852,752	87,250,757	6.71
	10–49.9	5,486,975	71,547,145	7.67
2003	250 or more	10,521,494	237,735,202	4.43
	50–249.9	5,974,240	92,458,500	6.46
	10–49.9	5,307,777	77,346,419	6.86
2004	250 or more	11,306,943	254,909,427	4.44
	50–249.9	5,732,432	100,942,795	5.68
	10–49.9	5,362,931	82,226,337	6.52

TABLE 4.4 FIELD LEADERS IN PROACTIVE MISSION INVESTING⁴²⁵

The Hutton Foundation	43.6 percent
F.B. Heron Foundation	26 percent
K.L. Felicitas Foundation	20 percent
Community Foundation of Sonoma County	14 percent
Needmor Fund	14 percent
Weeden Foundation	11 percent

TABLE 4.5 FIELD LEADERS IN INVESTMENT SCREENING⁴²⁶

Gordon and Betty Moore Foundation	100 percent screened
Needmor Fund	100 percent screened
Weeden Foundation	90 percent screened
Jessie Smith Noyes Foundation	80 percent screened
Nathan Cummings Foundation	17 percent screened
Charles Stewart Mott Foundation	
Robert Wood Johnson Foundation	
William Penn Foundation	
Kresge Foundation	
Heinz Endowments	
Conservation Land Trust	
Educational Foundation of America	
Edward W. Hazen Foundation	
Max and Anna Levinson Foundation	
Merck Family Fund	
The Christopher Reynolds Foundation	
William Caspar Graustein Memorial Fund	
The William Bingham Foundation	

TABLE 4.6 FIELD LEADERS IN SHAREHOLDER ACTIVISM⁴²⁷

Jessie Smith Noyes Foundation	25 percent of portfolio; close to 300 companies voted on in 2008
Nathan Cummings Foundation	5 percent of portfolio; filing 16 resolutions in 2009
Camilla Madden Charitable Trust	
Conservation Land Trust	
Edward W. Hazen Foundation	
Lemmon Foundation	
Max and Anna Levinson Foundation	
Needmor Fund	
Wisdom Charitable Trust	

dollars to advance its charitable purpose. Informed by giving trends for total grants in the analysis above, a grantmaker working in the Philanthropy at Its Best framework maintains a generous payout level with a minimum of 6 percent dedicated to grants for non-profit partners.

The limited mission investing data currently available make gauging sector-wide trends challenging. As noted, the IRS form 990 PF does not collect data on foundation mission investment; foundation self-reporting is the sole source of this information. According to available data, few foundations are engaging in Philanthropy at Its Best in terms of mission investing. However, given the three strategies that will count toward a grantmaker meeting or exceeding this criterion, NCRP believes that all foundations easily can take the minimal step of screening investments, with an eye toward engaging meaningfully in shareholder activism and substantive proactive mission investing.

Several public charities and community foundations, such as the Boston Foundation, Funding Exchange, the Haymarket Fund, the As You Sow Foundation and the Tides Foundation⁴²⁸ engage substantively in mission investing. While this criterion applies primarily to private foundations, public charities could serve as an important resource for those grantmakers new to this type of investment.

The principle undergirding this criterion is that tax-exempt assets should not be warehoused; rather, they should be put to use in support of the charitable purpose of the foundation. The key is an appropriate balance of payout and mission investing informed by the metrics established in this chapter. For example, a foundation might decide to show its commitment by spending down its assets in the short term but might decide not to engage in mission investing. A foundation that seeks to exist in perpetuity and also practices exemplary philanthropy would pay out 6 percent in grants only while also ensuring that at least 25 percent of its assets are invested in ways that support its mission.⁴²⁹

CONCLUSION

Most foundations use only a tiny fraction of the financial assets at their disposal to achieve their missions. Many foundations continue “traditional payout policies,” paying out only 5 percent of their assets in qualifying distributions each year and do not prioritize the potential mission-advancing power of their invest-

ment assets in non-grantmaking ways. As a result, a significant opportunity for broad, long-term changes and advancing a foundation’s mission is lost. Foundations should dedicate substantial portions of their endowments toward achieving their charitable purposes. As this section demonstrates, warehousing of tax-exempt dollars does not serve the public interest; it shortchanges the social benefit of philanthropy. The many socially-responsible and mission investing mechanisms available to a foundation demonstrate that such investments can minimize risk and provide reasonable returns and do not present high-risk options. By maintaining a generous grants payout and investing a substantial portion of its assets in a manner aligned with its mission, a foundation can increase its impact and demonstrate its commitment to achieving its charitable purpose.

Criterion IV: Commitment

A grantmaker practicing Philanthropy at Its Best serves the public good by engaging a substantial portion of its financial assets in pursuit of its mission.

- a) Pays out at least 6 percent of its assets annually in grants
 - b) Invests at least 25 percent of its assets in ways that support its mission
-

DISCUSSION QUESTIONS

NCRP encourages staff and trustees of foundations and other grantmakers to engage in serious discussions about each criterion and the chapter that elaborates on the criterion. Sample discussion questions are provided here to help get you started.

- > Which parts of the chapter did you like the most? Why?
- > Which parts did you like the least? Why?
- > Do you agree that it's important to engage a substantial portion of our financial assets in pursuit of our mission? Why or why not?
- > What percentage of our foundation's assets do we pay out in grants each year? How did we establish that percentage? Are we satisfied with that percentage? Why or why not?
- > Have we ever considered had an intentional discussion about mission investing? What percentage of our foundation's assets do we invest in accordance with our mission? (Include screening, proxy voting or shareholder activism, and proactive mission investments.)
- > How did we establish that percentage? Are we satisfied with that percentage? Why or why not?
- > Are there ways we can use other investment assets at our disposal to achieve our mission?
- > What else from this chapter should inform our current grantmaking priorities?
- > If we want to make any changes based on this discussion, what will need to happen in order to make those changes? What are the next steps?

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