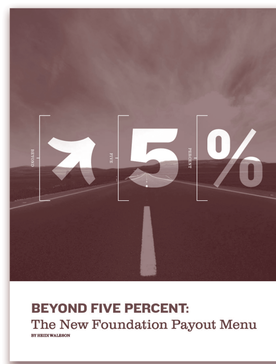
Beyond Five Percent: The New Foundation Payout Menu

By Heidi Waleson

The National Committee for Responsive Philanthropy has long advocated that foundations should pay out more than the legislatively-mandated minimum. Our position has been based on the idea that the warehousing of tax-exempt dollars serves no public purpose and that society would see real benefit from getting more funding into the hands of nonprofit organizations doing important work in communities. In 2004, NCRP lost a bitter legislative battle that would have mandated an increase in foundation payout. Even though Congress hasn't changed the laws governing private foundation payout, many foundations voluntarily have chosen to spend at higher rates. Below is an excerpt from Beyond Five Percent: The New Foundation Payout, *a report by the Northern California Grantmakers, the New York Regional Association of Grantmakers and the French American Charitable Trust that gives examples of how foundations have challenged tradition and given more in their annual grants than was required legally. We hope that the report will inspire foundations to seriously consider increasing their annual giving as an effective way to fulfill their mission and have a real impact on the most pressing issues facing society today.*

In 1991, the governing committee of the Whitaker Foundation, which had been supporting the development of biomedical engineering since the foundation was established in 1975, felt that the time was ripe for a large investment in the field. They determined that a program of grants to establish and strengthen fledgling university biomedical engineering departments was the best use of the foundation's assets, and in order to pay for that investment, decided to spend down the entire corpus in 15 years. By the time the foundation closed its doors in 2006, it had poured over $800 million into biomedical engineering, effectively jump-starting the field, which now has nearly 80 departments.



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Whitaker is an example of a foundation that, driven by its mission, chose a non-traditional path with respect to lifespan and payout. The vast majority of U.S. foundations, which number about 71,000, are set up to exist in perpetuity, replenishing their assets through investment, with the expectation that their money will be around to address the problems of the future as well as those of today. The majority of foundations also pay out, in grants and administrative costs, around 5 percent of their assets each year, the minimum required by U.S. law. This rate initially was set at 6 percent by the Tax Reform Act of 1969, and revised to 5 percent in 1976. Such practices have become the default position for foundations. (For the purpose of this paper, perpetuity and 5 percent payout are termed "traditional" foundation practices.)

Why is this so? For some foundations, perpetuity is dictated explicitly in the founding documents, but that is not the case for all. Analyses that tackle the issue of the time value of money, attempting to determine the relative value of a dollar spent on philanthropy today vs. in the future, yield contradictory results. The issue of payout percentage has been subject to debate, with various studies taking different positions as to the long-term effect of different rates on the corpus, but the general assumption in foundation circles still is that the 5 percent payout rate is the number that will enable foundations to maintain their purchasing power into the future. In their 2001 study of foundation payout rates, Askash Deep and Peter Frumkin list five excellent reasons for and five against a payout higher than 5 percent, which in theory should result in a more diverse payout landscape.

However, these scholars found that "the weight of tradition and professional experience" is a critical reason for the convergence of foundation payout rates at around 5 percent.

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For example, trustees see their "duty of care" as an instruction to "preserve assets for the future," a large endowment confers status, and, given the many priorities involved in running a foundation, it is easier — and less risky — to do what everyone else does, rather than come up with a rationale and a system for doing it differently. (For more details on the payout debate, see "Money, Mission and the Payout Rule," by Thomas J. Billitteri, an Aspen Institute study.)

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However, a number of donors and foundations are challenging these assumptions, taking the position that considerations other than perpetuity and payout should determine the structure of their giving. Some believe that certain fields of interest (for example, the protection of the environment) urgently require more money now. Some feel that higher payout and/or a shorter lifespan will yield more effective philanthropy with greater impact. Some, like Whitaker, see the potential to address — and solve — a single, identifiable issue with more concentrated funds.

Donors may prefer to maintain personal control over their philanthropy, and thus plan to do their giving during their lifetime, and/or establish a time limit for their foundations after their death, in order to preserve donor intent. Some want to see all their money working now. Some dislike the idea of bureaucracy, and feel that the structure of traditional foundations is more oriented toward preserving capital than toward doing good. Some feel that with new fortunes being made and inherited, that future needs will be taken care of by future donors.

NEW STRUCTURES FOR GIVING

Such donors and foundations have had to find different ways to structure their giving, coming up with models that turn the traditional philanthropic paradigm on its head. Perhaps the most dramatic recent example was Warren Buffett's decision to give $30 billion to the Gates Foundation, rather than start his own. Buffett reasoned that Gates already had a system for giving away large amounts of money, in areas that suited his own philanthropic interests. One twist is that the Buffett money does not go into the Gates corpus; it will be given over a period of years, and spent as it is given — rather like the biggest donor-advised fund ever. The Gates Foundation followed up on the Buffett gift with its own surprising announcement — that it would sunset 50 years after the death of its last founding trustee.

Such unusual foundation structures may include a limited lifespan. The Whitaker Foundation, established after the death of the donor, chose to spend down its assets entirely within a specified number of years. Foundations like the Beldon Fund and Atlantic Philanthropies, both set up by living donors, may establish a term for spend-down that may or may not be

> "As of 2005, foundations held $550 billion in total assets, and the majority of foundations in the United States are set up to exist in perpetuity. Most pay out, in grants and administrative costs, around 5 percent of their assets each year, the minimum required by U.S. law. But there are many examples of grant makers who are driven by their mission and decide to give more each year. This report provides stories of donors and foundations that have chosen to move beyond the default 5 percent and structure their giving in new ways — from flexible payout to limited life. This report gives valuable information to donors and foundation officers who are open to thinking about a higher payout for their foundation and how this benefits their grantmaking."
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> — Diane Feeney, President of the French American Charitable Trust and Vice Chair of the NCRP Board of Directors

longer than the life of the donor. Others, like the Richard and Rhoda Goldman Fund and the Lewis B. and Dorothy Cullman Foundation, have sunset provisions, planning to go out of business in a definite number of years following the death of the donor or family members.

Foundations that are not intending to spend down may adopt payout rates higher than 5 percent, believing that greater expenditures are necessary to fulfill their missions. The Bradley Foundation, for example, pays out at a rate of 5.5 percent in grants only (not including administrative costs), and has maintained the purchasing power of its endowment. The Evelyn and Walter Haas, Jr. Fund has increased its payout rate to a minimum of 5 percent in grants only in order to address pressing issues, with the understanding that, depending on investment returns, a smaller corpus may be passed on to the next generation of family trustees.

Some foundations establish flexible payout rates, which vary from year to year depending on opportunities. The HKH Foundation, for example, increased its giving by one-third before the 2004 elections, a moment that it felt was propitious for increasing civic engagement. The Needmor Fund maintains a 6 percent payout rate as a base, but actually gives a great deal more because a network of involved family members provides additional annual support that is earmarked for current grantmaking.

Unusual structures in foundation operations go beyond changes in lifespan and payout. Some foundations have chosen to fulfill their missions through activities other than grantmaking, including running their own charitable initiatives and investing in for-profit enterprises with social goals. The Haigh-Scatena Foundation's sole employee, its executive director, spent half his time consulting with the foundation's grantees. The Omidyar Network invests in both nonprofit and for-profit enterprises, and includes an online networking component. The Endswell Foundation/ Renewal Partners, a time-limited entity, parlayed a relatively small asset base into charitable and for-profit investment in British Columbia, including the development of the Tides Canada Foundation, a public foundation, which now administers grantmaking for Endswell and others.

This paper looks at 13 foundations, and examines the ways in which their non-standard structures — whether in the areas of lifespan, payout or methods — arise from their missions. For many of them, the choice to do things differently has meant that they have had to invent their own methods to carry out their work. While it is a given in the field that every foundation is different, some are more different than others, and the kinds of rethinking required by these unusual foundations yield lessons not only for those who are considering following in their footsteps, but for all foundations and donors.

The full report may be viewed for free online at http://www.ncg.org/assets/beyond5/Beyond5_Report.pdf.

A FOUNDATION IN FOCUS

The Evelyn and Walter Haas, Jr. Fund

One of the foundations Beyond Five Percent features is the Evelyn and Walter Haas, Jr. Fund, a private family foundation in San Francisco, Calif., that decided in 2001 to set a minimum all grants payout of 5 percent. Although spending down wasn't the intent in making the decision to increase their grantmaking, the board and staff realized that such a move might one day mean a decrease in foundation assets.

In the report, the foundation's president Ira Hirschfield says, "We haven't made the decision to spend out. … Because of the markets, last year was a good one, and the corpus actually grew from $549 million to $599 million after grants and expenses. This was more than the inflation rate, so the Fund did more than maintain purchasing power. But even if the assets hadn't grown so well, we wouldn't have changed these decisions. We understand our decision to do a minimum of 5 percent in grants only could one day decrease our corpus, and we're comfortable with that possibility."

He also says that their new policy has changed how and with whom the foundation collaborates. "With $500,000, you could do good work in immigration reform. With $4 million, you can start asking a different set of questions to address immigrants' needs, as well as deepen collaborations with other funders working across the country."