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Endowment Resource for Charities Facing Financial Challenges

Nonprofit organizations and universities (collectively “institutions”) may face unexpected debt and repayment obligations, causing them to make difficult financial decisions. Some institutions in these circumstances may be tempted to draw money from their donor-restricted endowment funds. Such funds, however, have certain restrictions and institutions must be careful when considering this option. The Attorney General’s Charitable Trust Unit offers these guidelines to institutions examining their endowments as a potential source of funding to address financial challenges.

This document does not contain legal advice. An institution facing financial challenges should consult with legal counsel to discuss potential courses of action.

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I. Background on Endowment Funds and Governing Law

Many charities hold endowment funds, which broadly speaking are donor-restricted funds that are intended to be invested and used to perpetually sustain charities and their missions. The Attorney General oversees the administration of

endowment funds and other assets that charitable nonprofits and charitable trusts hold throughout the State.

In particular, the Attorney General is a necessary party to a charity's request for judicial relief to modify charitable restrictions – including endowment restrictions subject to the Uniform Prudent Management of Institutional Funds Act, MCL 451.921, *et seq* (UPMIFA).

Most Michigan public charities holding donor-restricted endowment funds are subject to UPMIFA. Pursuant to UPMIFA, endowment funds have three necessary characteristics. First, endowment funds are held exclusively for charitable purposes. These purposes may be for the institution's general charitable purposes or more specific charitable purposes such as scholarships. Second, they cannot be spent by the institution all at once. Only a portion of an endowment fund may be spent throughout the year (most often a portion of the income earned) in accordance with UPMIFA's rules on prudent expenditures and the institution's internal spending policies.¹ Finally, endowment funds are donor restricted.²

As a donor restricted account, financially distressed institution must look to other sources of funding before seeking to use endowment funds. If it cannot find those sources, it may be possible to get court approval to release endowment restrictions on a limited basis. It is important to note, however, that an endowment is not a bank account of last resort. It is generally a permanent fund.

Before appropriating (spending or using) or accumulating (saving) endowment assets, an institution must consider, if relevant, all of the following factors:

- (a) The duration and preservation of the endowment fund.
- (b) The purposes of the institution and the endowment fund.
- (c) General economic conditions.
- (d) The possible effect of inflation or deflation.
- (e) The expected total return from income and the appreciation of investments.
- (f) Other resources of the institution.
- (g) The investment policy of the institution.

¹ The average effective spending rate from endowments in fiscal year 2019 was 4.5%. [Press Release, 2019 NACUBO-TIAA Study of Endowments, National Association of College and University Business Officers & TIAA](#). As a practical matter, the institution's governing board decides what percentage of the endowment fund to spend on the fund's charitable purposes in any given year. Note, in addition to expenditure restrictions, endowment funds may also be subject to specific use or purpose restrictions.

² Although by definition endowment funds are necessarily also institutional funds, this guidance is limited to endowment funds because institutional funds (as defined by UPMIFA) are a broader category.

(See MCL 451.924)

These factors are almost always relevant to any decision regarding an endowment. However, they are generally not given equal weight. The duration and preservation of the endowment fund is generally considered the most important factor.

To help protect itself, an institution that reviews its spending policy and these factors annually, should detail in writing (such as in meeting minutes or a resolution) its review and weight given to the factors.

An institution and its board must act in good faith, with the care that an ordinary prudent person in a like position would exercise under similar circumstances, with duties of loyalty, in all aspects concerning an endowment. This includes, but is not limited to, decisions to use endowment funds, setting spending policy rates, and selecting, contracting with, and monitoring agents.

II. Exploring Other Options Before Seeking Court Approval to Modify Donor-Imposed Restrictions on Endowment Funds

As a practical matter, before seeking Court approval to release endowment restrictions on a limited basis, it is expected that institutions will have explored the following options:

- Can the institution raise new, unrestricted donations?
- Is there funding available through federal or state sources?
- Is there grant funding through private foundations?
- Are there other financing or refinancing options, including through commercial banks?

These other funding mechanisms may be effective ways to address financial gaps without seeking to modify restricted endowment funds.

Also, institutions should assess whether the following nonjudicial remedies are viable options:

Ask donors to release spending restrictions. Institutions and counsel should consider whether it is feasible to contact donors to obtain their consent to lift or modify the spending restrictions on donor-restricted endowment funds.³ UPMIFA expressly provides that institutions may release or modify restrictions imposed on

³ Institutions may consider similar measures in assessing other donor-restricted funds that are not subject to spending restrictions.

endowments funds with donor consent. The particular modification will depend on any agreement reached between the institution and the donor. But, with donor consent, the institution may access the modified fund (or a portion) to further the fund's charitable purpose, subject to applicable fiduciary duties of care and loyalty.

Consider endowment spending adjustments. Institutions anticipating revenue shortfalls or extraordinary costs may be able to increase endowment fund spending in a given year, with the potential for downward adjustments in later years. Although UPMIFA provides authority for an institution to increase or decrease its draw from an endowment fund, there are general principles that govern increased draws: the institution should maintain its purchasing power (i.e., the fund must grow to keep pace with inflation); the endowment fund may not be expended all at once; and donor intent must be respected.

Pursue administrative modification of small and old funds. In limited circumstances, court approval may not be required for modifications of endowment funds with less than \$25,000 and that have been in existence for 20 years or longer. (See MCL 451.926.) Institutions seeking to administratively modify the endowment must provide notice to the Attorney General.

If the above strategies do not work or are unavailable, taking loans from the endowment, retroactive increases in past draws, and other creative solutions, are mostly illegal. A loan from an endowment is generally improper absent a court ordered modification of the restrictions on the endowment, with notice to the Attorney General, and an instrument securing the debt. A retroactive increase in past draws, claiming to increase past draws that may have been conservative or in error, is an improper draw. In reality, the retroactive draw is a draw occurring today and not five or ten years ago. The organization must evaluate the UPMIFA factors for a draw. Those factors concern the current conditions and future of the endowment.

IV. Submitting Requests to Modify Endowment Funds to the Attorney General for Review

Importantly, if an institution decides to pursue judicial relief, the Attorney General is a necessary party to any such action. If, after exploring the above, the institution decides that it will seek Court approval to modify the endowment, it should first contact the Attorney General's Charitable Trust Unit to discuss the proposed petition, judicial relief, and any related considerations. The institution should be prepared to provide the Attorney General, and include or attach to the petition as appropriate, the following:

- A description of the circumstances that led to the current financial situation and steps taken to ameliorate the financial crisis, including reference to any alternatives explored.

- If the institution seeks to take the extraordinary measure of borrowing from an endowment fund (which requires court approval), it should provide proposed security, and assurances that outline a business plan for repayment and viability.
- A clear articulation of how the facts and circumstances necessitating relief meet a standard for modification under UPMIFA.
- A description as to how such extraordinary measures will further the purposes of the endowment fund, the donor's probable intent, and/or the charitable purposes of the endowment fund.
- An agreement to make periodic reports to the Attorney General regarding repayment and financial health, as appropriate.

V. Seeking Court Approval to Access Donor-Restricted Endowment Funds

For institutions that have exhausted alternative funding options or otherwise have determined that accessing endowment funds is necessary, modification proceedings before the court may be available. UPMIFA addresses such requests and describes the circumstances and standards that may be applicable. Institutions should consult with counsel for appropriate legal advice. What follows is a general overview of the potential legal remedies.

Michigan courts may modify endowment funds in limited circumstances. (See MCL 451.926.) The first set of circumstances is where the restriction has become impracticable or wasteful, where it impairs the management or investment of the fund, or where, because of circumstances not anticipated by the donor, a modification of a restriction will further the purposes of the fund. The second set of circumstances is where a particular charitable purpose or a restriction contained in a gift instrument becomes unlawful, impracticable, impossible to achieve, or wasteful.

Whether to seek judicial relief depends on the facts and circumstances of each case, the specific relief sought, and whether the institution meets the requisite evidentiary standards. Again, the Attorney General is a necessary party to any such action.

An important factor that the Attorney General's Charitable Trust Unit will consider in reviewing a modification of an endowment's restriction is whether such

borrowing or invasion of the endowment fund will materially increase the likelihood of the institution's continued operations in furtherance of its mission. If the proposed action will merely delay the impending closure of the institution, then a modification of an endowment fund's spending restrictions may not be appropriate.

VI. How the Charitable Trust Unit Can Help

The Attorney General's Charitable Trust Unit is available to assist institutions. It will work with institutions to remedy issues and help them find a path forward. The Charitable Trust Unit can be reached at, P.O. Box 30214, Lansing, MI 48909-7714. It is also [available by email](#) and phone, 517-335-7571.