The Grenzebach Glier Quarterly Review

Philanthropic News and Analysis

Spring 2007

Donor-Advised Funds: What's Behind Their Growing Appeal?

Investments in donor-advised funds are skyrocketing. Their rapid growth is driven by several factors, particularly significant tax advantages, and, for some, a means to avoid the possible future complications of family foundations. The use of donor-advised funds frees donors to focus their attention and energies on what they most care about — philanthropy — and smart charities are working with donors to meet their needs for broader giving options. Yet this highly appealing medium for charitable giving is under scrutiny, since the U.S. government in 2006 launched a review of the tax advantages provided by donor-advised funds.

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Congress Reviews Donor-Advised Funds

Policy makers, charity watchdogs, and nonprofits are keeping a close eye on donor-advised funds. *The Wall Street Journal* ("Are Donor-Advised Funds in Jeopardy?" by Arden Dale, April 17) reports that charities have deluged the Internal Revenue Service with requests for a study the agency was ordered to do under the Pension Protection Act of 2006. The Treasury Department has called for comments on issues including donors' retained rights to determine charitable beneficiaries and whether a required charitable distribution should be established. Results of the study will be reported to the Senate Finance and House Ways and Means Committees in August. *The Quarterly Review* will provide updates on the inquiry and how its outcome will affect donors and not-for-profit organizations.

In This Issue

The Shifting Landscape of Family Foundations

Family foundations have multiplied in recent years, fueled by favorable tax laws and the charitable energies of their founders, to become major philanthropic forces. Yet, perhaps more than other philanthropic institutions, family foundations are susceptible to changes in direction over time. In some cases, founders of high-profile foundations based in the United States are electing to distribute their assets at a specific point in time. Canada, on the other hand, is experiencing a boom in new family foundations. And, across the continent, long-established family foundations work to re-invent concepts of philanthropy and engagement for new generations.

While wealthy families are setting up new philanthropic foundations in increasing numbers, they are also shutting them down at an accelerating pace, reports Sally Betty (*The Wall Street Journal*, "Families Wrestle with Closing Foundations," April 17). In addition to the Bill & Melinda Gates Foundation, which will spend its

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Donor-Advised Funds: What's Behind Their Growing Appeal?

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The nation's largest donor-advised funds reached $19.2 billion in 2006, up more than 21 percent from $15.9 billion a year earlier, according to a recent survey by *The Chronicle of Philanthropy* ("A Surge in Assets," by Noelle Barton and Peter Panepento, May 3). *The Chronicle* also found that donors gave more to donor-advised funds — $6 billion in 2006, up from $4.8 billion in 2005.

A donor-advised fund is established by an individual donor through an irrevocable transfer of assets to a fiduciary agent; that fiduciary may be either for-profit ("commercial") or not-for-profit. Donor-advised funds provide up to three tax benefits: an immediate income tax deduction, avoidance of capital gains tax on gifts of appreciated property, and a reduction of the gross estate by the amount of the excluded asset.

> *"The popularity of commercial gift funds is leading more nonprofit organizations to offer them."*

The nation's largest donor-advised fund, the 16-year-old Fidelity Charitable Gift Fund, posted a 76 percent hike in new accounts last year, reports Kathie O'Donnell ("New accounts up 76% in '06 at Fidelity's charitable fund," *Investment News,* January 15, 2007). Fidelity lowered its fees on most accounts by at least 40 percent and dropped its minimum investment from $10,000 to $5,000, gaining more than 4,650 new accounts in one year and reaching $3.5 billion in assets.

Community foundations, as well, are jumping on the donor-advised fund bandwagon. According to the Council on Foundations, 85 of the 125 largest community foundations in the country reported that they held more than 21,500 donor-advised accounts in 2005, with assets totaling $6.55 billion. Overall, donor-advised funds made up about 26 percent of these foundations' total assets and about 40 percent of their total number of funds.

"The popularity of commercial gift funds is leading more nonprofit organizations to offer them, giving the well-established funds a run for their money," Kem Srmiska, a managing director at the Council

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An international leader in philanthropic management consulting, Grenzebach Glier and Associates, Inc. (GG&A), has more than 45 years of experience with educational, cultural, medical, and other nonprofit institutions. The goal of the *Review* is to provide timely information about issues and events that are relevant to philanthropy.

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on Foundations, told *Investment News,* commenting on the widespread appeal of Fidelity, Schwab, Vanguard, and other for-profit fiduciaries.

The Draw for Donors

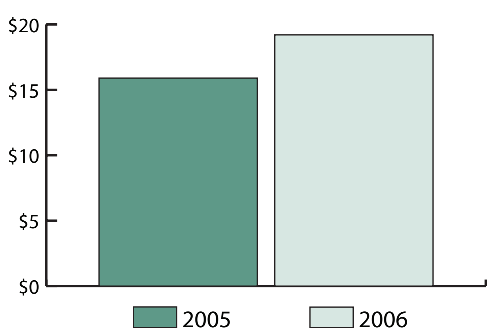
Donor-advised funds have been available for years at **Brigham Young University**, although they were not aggressively marketed, says McClain Bybee, managing director of LDS Philanthropies, the development arm of Brigham Young. Originally, the funds were earmarked for large gifts, "but we have lowered our minimum investment in a donor-advised fund to $10,000 so more families can participate. We will watch the market to determine if that minimum should be lowered to $5,000 in the future."

In addition to the immediate and long-term tax benefits of such gifts, Bybee cites other attractions: donor-advised funds are easy and cost-effective to create and manage; are less complicated to establish than private foundations or trusts; are easier to disburse; and have greater flexibility than a public charity.

Donors also have the luxury of designating a gift to a donor-advised fund at any time and determining later which charity or charities to support. Strategies vary among donors, Bybee notes. "Some people use donor-advised funds as parking places. They can give an asset away quickly to realize tax advantages, but wait until the right time to select the charity to receive the gift."

Growth of Donor Advised Funds

(Dollars in Billions)



Source: *The Chronicle of Philanthropy*

The Cornell University Foundation—A Donor-Advised Fund was established in 1986 to help donors consolidate their charitable giving, but saw few contributions in its first years." Then when commercial donor-advised funds gained popularity, it took off," says John F. Murphy, senior trust officer for the fund.

Now, some 110 individuals participate in the foundation's donor-advised funds, with more than $100 million in gifts received in the last ten years. The university handles payment and administration functions for all gifts made from the account, with a payout of 40 to 50 percent of its assets annually.

"Many donors are now taking money from their private foundations and commercial funds and putting it into our donor-advised fund. It is convenient for large benefactors to have everything under one roof," says Murphy, noting the fund's $25,000 minimum and the requirement that at least 50 percent of each fund's holdings goes to Cornell.

Of **The Pittsburgh Foundation's** 1,100 funds, approximately 450 are donor advised, with a gift minimum of $10,000. President William Trueheart notes that older community foundations were created by trustee banks that invested only in their proprietary products. "Our board and financial advisers believe that their fiduciary responsibility requires ongoing monitoring systems to ensure the continuing economic conditions trigger product changes in investment strategies. We are concentrating on providing greater investment options through seven approved money managers," says Trueheart, a member of the

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Experts Offer Advice

On Donor-Advised Funds

- Gift vehicles change from time to time. Be careful not to put all your eggs in one basket. Donors are moving away from financial rewards and tax benefits as their primary motivators and are returning to true philanthropy. *McClain Bybee*

- Use donor-advised funds as door openers. Raise awareness and remind donors how funds, if invested in the institution's endowment, can give them access to alternative assets—hedge funds, private equity—out of reach of most individual donors. *John Murphy*

- The decision to create a donor-advised fund vs. a private foundation is the difference between renting and owning a house. You make the decision to start a foundation because you want to be in control of all key decisions, including investment policies and charitable strategies. *Hilary Pearson*

- You better have one-on-one relationships with individuals who have donor-advised funds. Institutions must carefully look at stewardship over the continuum of relationships. We are out of the era of prospect management. We manage relationships. *McClain Bybee*

Donor-Advised Funds: What's Behind Their Growing Appeal?

(cont. from page 3)

Building Strong and Ethical Foundations Advisory Committee of the Council on Foundations and of the National Panel on the Nonprofit Sector.

"Many donors are pushed by their advisors to establish commercial donor-advised funds or private foundations as their gift vehicles," says Cornell's Murphy who views the for-profit community as his chief competition. "But why pay management fees to a commercial fund and pay unnecessary legal, investment, or accounting costs?" Donor-advised funds, on the other hand, "avoid expenses, are easy to administer, and have no minimum annual distributions." The tax deductions are also better than for private foundations, he notes.

Philanthropic Imperative Is Bottom Line

A survey of LDS constituents by Harris Interactive found that some wealthy donors were moving funds from private foundations to donor-assisted funds with defined charitable interests to resolve family issues and to ensure their giving priorities extend beyond their death. "Through the donor-assisted fund, children with different interests can participate and the original donors' thoughts and beliefs can be perpetuated," explains Bybee.

Coinciding with the rise in donor-advised funds is a changing approach to planned giving. "Thirty years ago when you hired planned giving officers, they could fit everything into a charitable remainder trust. Today planned giving officers must be prepared to have conversations about values, family, and dreams and be familiar with a variety of gift vehicles to meet family needs," notes Bybee, who says LDS Philanthropies is seeing a decline in charitable trusts as more assets are transferred into donor-advised funds. "At first glance, it is difficult to see how we are not hurt. But these layers and layers of money are actually producing far more money that eventually will go to LDS Philanthropies."

The Baton Rouge Community Foundation recognizes, as well, the donor psyche and focuses on opportunities for donors to achieve their giving goals through a number of customized funds, according to John Davies, foundation president and CEO. "Donors rely on our knowledge of the community and its wonderful institutions to help them decide where to give."

Tax advantages of donor-advised funds aside, Trueheart says "often it is not tax benefits but rather the philanthropic commitments and passions of our donors that drive their decisions in choosing among giving options." Bybee agrees that mega-donors find the gift vehicles secondary to what they are trying to accomplish with their gifts. "You can't push the donor-advised fund to make it enticing; it must be viewed as a vehicle to assist the true philanthropy of the family." He also feels donors do not want to be heavily involved in choosing investment vehicles. "The majority of individuals want to create funds to make it simple and easy to carry out their philanthropic desires. Big donors don't want to spend time on investments; they want to spend time being philanthropists."

"THINK ABOUT IT VIVIAN. TOGETHER WE COULD MAKE ONE BIG, BEAUTIFUL FOUNDATION."

Legislative Scrutiny Poses Challenges

Recent regulatory changes to donor-advised funds pose stewardship and donor relations challenges to membership organizations.

"Donors who purchase our Premier Membership or a membership of greater value make a gift to the museum as well as gain the benefit of membership," explains Brian Williams, vice president of development for **The Children's Museum of Indianapolis**. "For those who do so through donor-advised funds, however, the membership component creates a stewardship and donor relations challenge."

According to new restrictions included in the Pension Protection Act of 2006, donors who make those gifts through donor-advised funds and their advisers are prohibited from receiving more than incidental benefits from gifts or grants made to a qualifying charity. That translates to no memberships.

"In complying with these restrictions, we do all that we can to educate and thereby avoid upsetting donors," relates Williams. "Donors need to understand that their funds could be penalized 125 percent of their 'benefit' if they are found in noncompliance." Williams has also had to remind donors that donor-advised funds may not be used to pay down any portion of a pre-existing pledge. "With new donors, we discuss early on how they plan to make their gifts: directly from assets, from a foundation, or from a donor-advised fund. If through a family foundation or donor-advised fund, we take special care in structuring the gift relationship."

Other institutions, he notes, are revising language in giving agreements to comply with the changing regulations. Instead of a legally binding pledge agreement, some institutions are using what they call "a non-binding gift intention form" to formalize a donor's intent to recommend a gift, rather than to confirm an actual pledge.

Donor-Advised Funds

More Options Demand Stepped-Up Stewardship

From ease in the initial establishment to convenience in making gifts, donor-advised funds are translating to greater donor satisfaction. And fund managers are stepping up their stewardship to meet changing donor interests.

Many younger donors want to know their gifts make a difference. "Donors are not afraid of making a major gift, but will stay next to you to make sure it is used correctly," says McClain Bybee, managing director of LDS Philanthropies, the development arm of Brigham Young University, who believes donor-advised funds are a great match for people who want to accelerate change to bring about their long-term visions.

"Many younger donors want to know their gifts make a difference."

Demonstrate Responsiveness

The Pittsburgh Foundation carefully examined donor demand and responded with "seven different avenues through which donors can become engaged with the foundation," says William Truehart, president and CEO of The Pittsburgh Foundation. The foundation has also accelerated the distribution of grants from quarterly awards to as frequently as weekly. "These, and other changes, have enhanced our services to donors and grantees."

The foundation has become increasingly aware of donors' desires or wishes to utilize the convenience of giving online. "We paid attention," Trueheart notes. The Pittsburgh Foundation now allows donors to use credit cards to contribute online to their donor-advised funds. "This critical electronic vehicle to serve the philanthropic and investment needs of our donors has been well received."

Today's donors are much more demanding and want more options, agrees Davies. "It is not enough to feel good about making a gift. Donors want to know that their gifts have changed lives."

Responsibility Beyond Borders

He notes that foundation supporters are younger than their predecessors and have diverse interests, particularly in the area of international grant-making. "We learned from Katrina that it is a small world. We received gifts from all over the world, and we recognize our donor base is less geographically anchored than in the past. International philanthropy adds complexity to our work and is more expensive for us to carry out, but we realize our responsibility goes well beyond our borders," adds Davies.

Trueheart concurs. "Our donors are sophisticated and continually seek greater philanthropic opportunities. We have seen an increase in donor-advised funds to provide support for international organizations. We have established programs for grants to NGOs in Canada, India, and Brazil, among others."

The Shifting Landscape of Family Foundations

(cont. from page 1)

entire endowment of more than $32 billion within 50 years of the death of the last of its three current trustees, other families are putting an expiration date on their foundations because they believe they can do more good by spending a lot of money over a short period of time, rather than doling out a set percentage of assets over decades.

Their reasons for closing are varied: family members squabbling over how to parcel out the cash, often after the death of the founder; concerns over the corrosive effects of money on future generations, even if it is held in a foundation; and worry that successive generations won't share the founders' political, social, or cultural beliefs.

However, increasing numbers of families in Canada are starting their own foundations. "More people are creating them, investing assets in them, and taking an interest in how those assets are disbursed," says Hilary Pearson, president of Philanthropic Foundations Canada. More than 4,000 private foundations in Canada represent in excess of $9 billion in investment assets. The majority of active foundations (84 percent) are family foundations.

Pearson attributes much of the recent growth in foundation assets in Canada to a tax policy change introduced in 2006 that eliminated the capital gains tax on gifts of stock to charities. "We've had a real boom in a concentrated period of time," says Pearson. A further change in 2007 that extends the exemption from capital gains tax for gifts of appreciated securities to private foundations will fuel a similar increase in donations to private foundations, although Pearson expects

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Summary Statistics for Family Foundations
2001 and 2005

	2001	2005[1]	% Change
No. of Foundations	27,804	33,994	22.3
Total Giving	$12,969,504	$14,028,469	8.2
Total Assets	$204,621,742	$233,179,446	14.0
Gifts Received[2]	$11,428,496	$11,926,655	4.4

Note: Dollars in thousands. Percent change represents current dollars. Excludes 2,736 family foundations that did not report giving in the latest fiscal year. These foundations held $2 billion in assets in 2005 and reported gifts received totaling $991.2 million.

[1] Figures for 2005 were estimated as of January 2007.

[2] The 2001 figure includes $2.1 billion in new gifts to the Bill & Melinda Gates Foundation.

Source: "Key Facts on Family Foundations 2006," Foundation Center

The Shifting Landscape of Family Foundations

(cont. from page 7)

a leveling off to occur in the next few years. Still, those tax changes are driving a struggle for donor-advised funds among public foundations, community foundations, and nonprofits — all of which are getting more aggressive and competitive.

The Changing Generations

Alexander Clowes, M.D., chief of vascular surgery at the **University of Washington** and president of The Clowes Fund, Inc., based in Indiana, finds his family foundation at a crossroads.

Created by his grandparents largely to protect their art collection, the Clowes Fund is now entering its fourth generation. "This is often the critical transition point for family foundations, when family ties are strengthened or the foundation falls apart," relates Clowes.

> *"The challenge is to remain true to the original donors, yet meet the changing interests of the latest generation."*

"The challenge is to remain true to the desires of the original donors, yet meet the changing interests of the latest generation." The fund largely supports education, social services, and the fine and performing arts.

Clowes notes that direct descendants may participate as members of the fund at age 30. "In terms of geography and interest, members of the incoming generation do not quite have the same kind of attachment as we did," he says, and he is working to solidify their involvement. "It is a very active process to keep them engaged. No rules are set in stone; it is all open to discussion."

As fund president he has three main priorities: keep the family together, support areas of designated interest, and improve the investment portfolio. These challenges are being met, in large part, by improving the fund's administrative staff. In recent years, the fund hired an executive director to oversee daily activities, define new goals for the fund, and manage the review and selection of grants. In its early years, the fund consisted solely of stock in Eli Lilly and Company, where his grandfather was a renowned researcher. The fund is now totally diversified, and financial consultants provide investment advice and execute the board's financial strategies.

Although no family members currently reside in Indianapolis, the foundation plans to remain in the city. "It is the geographic center of the country and of the family and we have the expertise in town to support us," Clowes explains. Three committees, in Indianapolis, New England, and the West Coast, composed of directors, members, and outside experts, now oversee the grant-making process.

Successors Make Their Marks

Some young people, to be sure, are looking for ways to make their marks on family foundations. Sharna Goldseker, 32, joined the board of directors of the **Goldseker Foundation** in Baltimore when she was 29, according to *U.S. News & World Report* ("Making Their Privilege Pay," by Kimberly Palmer, February 18). At the time, she felt there was a shortage of resources for young people preparing to lead family foundations, so she helped found 21/6, a New York based-division of the Andrea and Charles Bronfman Philanthropies that develops exercises to help young people think about their funding priorities. She also manages Grand Street, a group of 18-to-28-year-olds, who talk about what it means to lead a family foundation.

Orrin H. Ingram III, chief executive officer of Ingram Industries and vice chair of **Vanderbilt University's** $1.75 billion *Shape the Future* campaign, believes his father had the right idea. "My father had a concern about his children inheriting too much money. He took care of his heirs financially and entrusted the rest to make the world a better place. That was not a bad strategy," says Ingram.

"My father had a concern about his children inheriting too much money."

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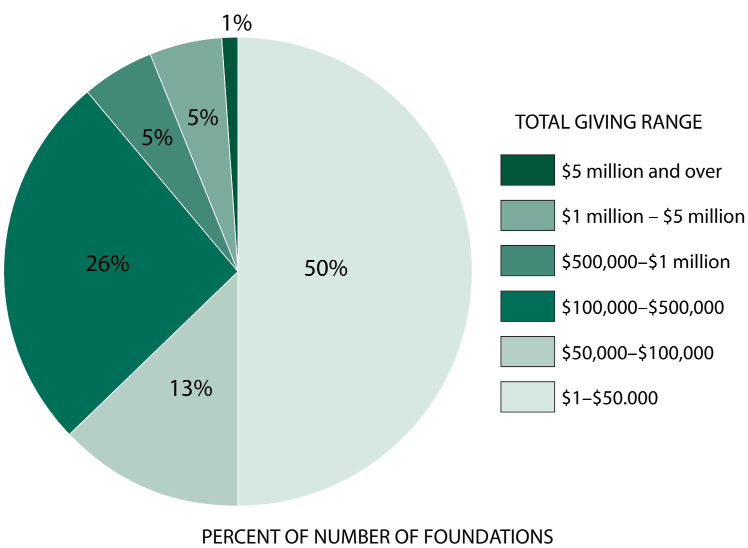
Half of Family Foundations Reported Less than $50,000 in Giving in 2005



Note: Based on 33,994 grantmaking family foundations. Excludes 2,736 family foundations that did not report giving in the latest fiscal year. Figures for 2005 were estimated as of January 2007.

Source: "Key Facts on Family Foundations 2006," Foundation Center

Experts Offer Advice

On Foundations

- Good relationships with coming generations are critical. In the case of private foundations, different generations may have different priorities, and the majority of their assets might never be distributed to charity. *John Murphy*
- Don't expect the same amount of funding from a family foundation every year. Decisions are based on priorities and they may change from year to year. Good stewardship throughout the year will prepare you for any changes. *Orrin Ingram*
- Run names regularly through GuideStar to see if donors have established family foundations. If a donor started with a half-million dollar donation that is now up to $12 million, or if a donor is doing extremely well on Wall Street, check regularly to determine if a family foundation has been created. *Luanne Kirwin*
- Don't just call a family foundation when you want money. Send correspondence, reports, and examples of success. A handwritten note means a lot. The more personal the communication, the better. *Orrin Ingram*
- Community foundations are wonderful resources. Senior development officers should try to understand their functions and develop relationships with them. They often are dominant players with lots of information on the wealth dynamic of a community. *John Davies*

The Shifting Landscape of Family Foundations

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> *"Part of what makes phil-anthopy fun is seeing how it affects organizations and the community."*

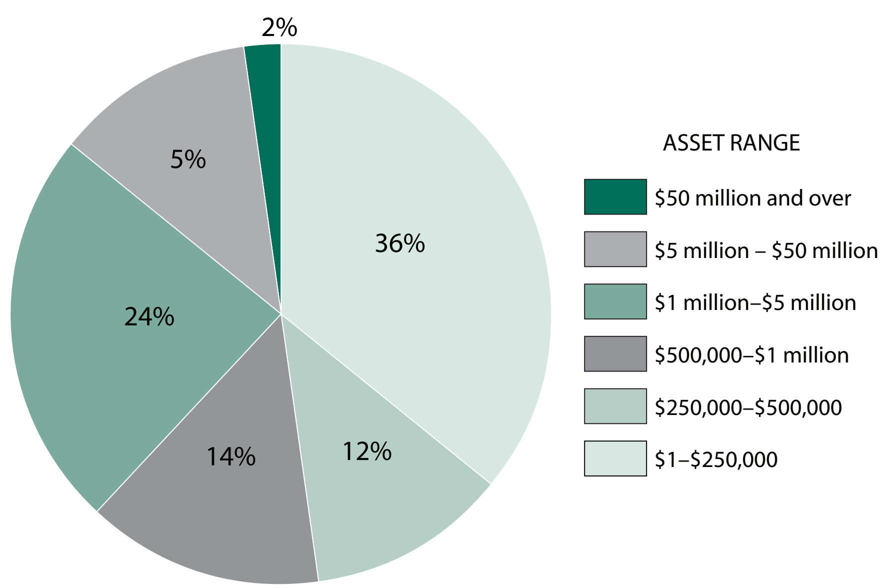
Following his father's death, Ingram, his four siblings, and his mother each created their own foundations. In addition, Ingram, his mother, and a brother, who own Ingram Industries, frequently make gifts to regions of the country and areas of interest represented by senior management of their company.

"Until recently, I fielded all the calls and requests to my foundation. We hired an executive director of community affairs five years ago," says Ingram. "The foundation has grown and we have been giving away more money, but we are maintaining our focus on public education, inner city youth issues, at-risk populations, and cancer research."

Ingram keeps most of his own support local. "There are many issues in our area that need attention. I don't feel I can make as much of a change with national causes. Part of what makes philanthropy fun is seeing how it affects organizations and the community," he says.

Ingram would love for his children to enjoy the same opportunities to give away money as they get older. "I would like the foundation to continue, but my children have to earn the right to give money away."

More Than Three-Fifths of Family Foundations Reported Less Than $1 Million in Assets in 2005



Note: Based on 33,994 grantmaking family foundations. Excludes 2,736 family foundations that did not report giving in the latest fiscal year. Figures for 2005 were estimated as of January 2007.

Source: "Key Facts on Family Foundations 2006," Foundation Center

Courting Private Foundations

On the receiving side of family foundation philanthropy, Luanne Kirwin, director of development at **Phillips Academy** in Andover, Massachusetts, is in an enviable position. "We deal with lots of family foundations, many with a long history of giving to Andover." With a good percentage of alumni among those Wall Streeters making it big in hedge funds, Kirwin deals with growing numbers of personal foundations that consistently pledge six-figure gifts.

She notes that donor-advised funds have not yet emerged as a primary gift vehicle for Andover donors. "For mega-gifts, we typically get a straight-out gift of stock or a gift annuity. Andover donors are very philanthropic and sophisticated about giving instruments."

Andover development staff members now do more reconnaissance on what donors are giving and how Andover should be positioned in those giving plans. "It makes a difference if we are dealing with an individual or a foundation," Kirwin explains. "It changes how we think about philanthropy and the size of gifts."

"We tend to be great sticklers and to spend money the way that was agreed upon by the donor and Andover. If we can't meet the criteria set by an individual or a foundation, we won't take the gift," she adds.

Foundation Sues Princeton Over "Misspent" Gift

Princeton University has reimbursed more than $780,000 to a foundation established by major donors Charles Robertson, a 1926 Princeton graduate and naval intelligence officer, and his wife Marie, an heir to the A&P fortune. The Robertsons' children accused Princeton of misspending a gift to endow the Woodrow Wilson School of Public and International Affairs ("Remaining True to Donor Intent," *The Grenzebach Glier Quarterly Review*, Summer 2006).

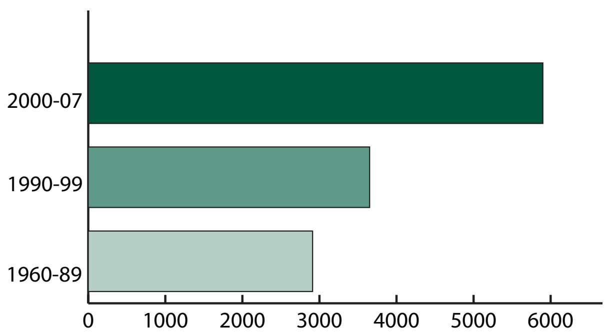
According to *The Wall Street Journal* ("Princeton Reimburses Donors' Foundation," by John Hechinger, March 13), Princeton returned the money because of "inadequate disclosure" to the family of its spending. But Princeton said the spending had been proper. The Robertson children say that their parents gave the university $35 million in 1961 to endow the Wilson School for a specific purpose: training graduate students for service in the federal government, particularly in foreign relations. Princeton says it has always been faithful to the Robertson parents' intent by supporting a broad public-service mission.

The relatively small reimbursement does not mean the fight is over. The Robertson gift fund, held in a separate foundation, is now valued at $800 million, or six percent of Princeton's $14 billion endowment. The Robertson children are suing Princeton, asking court permission to use the money for gifts outside of Princeton and to force the school to return all allegedly diverted funds with damages. Their lawsuit claims the university spent $207 million outside the guidelines established by the gift.

A Foundation Boom in Germany

Nearly as many new foundations were set up in Germany between 2000 and 2006 as in the previous four decades. According to the 2007 statistics in the Databank of German Foundations maintained by the *Bundesverband Deutscher Stiftungen* (National Association of German Foundations), the decades between 1960 and 1989 saw 2,911 new foundations; 3,651 were founded between 1990 and 1999; and in the first few years of the new century, 5,899 foundations have been created.

A Decade of Rapid Growth



Number of Foundations in Germany

How does Germany account for this exponential growth? One of the chief reasons is a recent change in the tax laws governing foundations. A 2000 tax law revision provided new income tax advantages and made it easier to set up charitable foundations. In addition, maximum deductibles were established of €20,450 annually for contributions to existing foundations and €307,000 for initial contributions to new foundations.

More Growth to Come

"The general growth in our society's wealth and better promotion of the foundation concept are other reasons for this trend," says Dr. Hans Fleisch, executive director of the *Bundesverband Deutscher Stiftungen*. While the new regulations have allowed strong growth in some types of foundations quite new to Germany, such as community foundations, that encourage participation by citizens of relatively moderate means, Dr. Fleisch sees some drawbacks. "Limiting the tax deduction for the initial donation to €307,000 sent the wrong signal. Too many of the new foundations are under-funded. Another revision of the tax law governing foundations, anticipated later this year, will correct this to allow a significantly higher deductible."

> *"Following this reform, Germany will become one of the foundation-friendliest countries in the world."*

"Following this reform, Germany will become one of the foundation-friendliest countries in the world," adds Dr. Fleisch. "The boom in the number of foundations will then be matched by a boom in the size of their assets."