Understanding Foundation Finances

Financial Oversight and Planning for Foundation Boards

By Lisa M. Eslinger

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Foreword

"In the past, public university foundations raised private funds to help provide 'a margin of excellence' in academics. Now we're being asked to raise funds for necessities."

"Decreased state support has been the number one tuition cost driver at our institution."

"The economic disaster in 2008 shook the markets like nothing we could have imagined—it forever changed the way we look at investments, spending policies, cash reserves, and risk management."

"Retention tops the list of strategies needed to improve the revenue picture. Too many students drop out for financial reasons."

"Many would-be first generation college students fear taking on debt. They get 'tuition sticker shock' and don't even try to navigate the financial aid process."

These are just a few statements about the challenges facing public institution that we at AGB hear from university presidents, foundation chief executives, and board members as they work to balance budgets, control costs, and maintain educational quality. In this environment, foundation boards are being asked to raise ever-increasing amounts of funding from private sources.

Recently, criticisms about the high cost of college reached a new crescendo. The aggregated figure of student debt passed the $1 trillion mark in mid-2013. Economists joined the chorus, pointing out that such high levels of student loan debt place pressure not just on the individuals, but on the economy as a whole as they prevent people from buying homes, cars, and other purchases.

Public institutions simply cannot go on with "business as usual." State support accounts for a smaller percentage of public institution revenues than it did in the past. Public concerns about student costs and debts mean that boards and administrations will not, as they have in the past, be able to increase tuition prices enough to fill the gap. Universities fail to heed the calls for greater affordability at their peril. Some lawmakers want to step in to force greater spending of university endowments and reserves to reduce tuition costs.

But simple cost-cutting or increased endowment spending will not solve the financial challenges, nor allow institutions to reach higher academic goals. And the bar for success has never been set higher. National goals call for 60 percent of the U.S. population to have some degree or level of certification to meet our workforce needs by 2025. (That figure is currently only 38 percent.) If this worthy goal is to be met, it will fall primarily upon public colleges and universities to effectively carry the statistic up.

Foundations will likely play a critical role in helping public institutions reach their goals to make college more affordable, accessible, and attainable. Only with the help of private funds—most likely raised and managed by foundations—will public institutions be able to make the numbers work, provide financial support for students, and invest in necessary capital projects.

While it is clear that foundations alone cannot possibly raise enough funds to close the gaps, what is needed is innovative financial thinking, public-private partnerships, and new avenues of revenues. Addressing the challenges requires buy-in across campuses from all players in shared governance: boards, presidents and their administrators, and faculty members. Institutions must become more entrepreneurial and creative in financing and fundraising endeavors and in forging partnerships on and off campus.

This new book *Understanding Foundation Finances*, explores in detail the distinct financial roles and responsibilities of a public foundation board and highlights national best practices. A case study (Chapter 4) examines how one university and its foundation were able to rise to the challenge and create an improved foundation business and financing model to enhance fundraising. We highlight this example to illustrate the kind of collaboration from across the entire university community that is needed to address the challenges together.

We also express our sincere appreciation to Russell Investments for their generous support of this publication.

Foundations bring to campuses many accomplished and well-connected volunteers who have strong commitments to the good work of the college or university. We thank you for your board service and support. We hope this book will help you to not only better understand your foundation's financial operations but will also encourage you to think creatively about how your foundation might better support the fundraising and financial stewardship goals set by your host institution.

Richard D. Legon
AGB President
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Chapter 1

A Changing Landscape for Foundation Finances

Today, more than 1,200 institutionally related foundations support excellence in the American public higher education system. The sound stewardship of a foundation's finances—budget, endowment, planning processes, and policies—is central to the fiduciary responsibility of its governing board. This book aims to inculcate financial savvy within foundation governing boards, focusing on what is most important for board members to understand, monitor, and do. But first it is helpful to take a look at the current higher education landscape in which foundations operate.

Traditionally, foundations have been essential in helping public universities remain competitive academically with top private universities. Foundation funds can be critical to attracting and retaining high quality faculty and students. Foundations support scholarships, endowed faculty seats, upgrades in technologies, facilities, innovative programming, faculty research, and much more.

Over the years, as state legislatures tightened public funding of higher education, private support has become a much larger and more important part of the revenue picture. Most public institutions no longer have the luxury of considering private gift dollars to be "above and beyond." Donations are needed for many essentials—such as building maintenance—that states used to provide.

And, beyond securing donations, foundations are needed, more than ever, to help facilitate engagement with the private sector and to provide a mechanism for alumni and others to work well with the institution. For public institutions that are part of state-wide systems with no separate governing boards of their own, a foundation board can serve as a valuable resource to the institutional president, providing a sounding board for ideas and feedback from outside of academe.

Major Benefits of Foundations to Their Host Institutions

1. Meaningful opportunities to **engage** influential board leaders.
2. A vehicle to **secure donations** and fulfill the trust of donors.
3. Flexibility in expenditure and **management of funds**.
4. Ability to **seize opportunities** outside of state appropriations.

Source: *Effective Foundation Boards: A Guide for Members of Institutionally Related Foundation Boards* (AGB, 2012)

Trends and Challenges

A number of issues and trends are affecting the landscape in which foundations operate. Here are eight challenges board members should be aware of:

1. Growing Pressures for Funds, Especially Unrestricted Gifts

Growing demands on state government dollars may change the way foundations and their boards think about fundraising campaigns and how they solicit donations. Historically, foundations have focused on asking donors to support causes closest to their hearts. In the future, campaigns may need to solicit more gifts that can be used broadly "for areas of greatest need" (i.e., unrestricted funds), much as independent institutions are able to do.[1] The financial volatility preceding the "great recession" drove home the need for strong levels of reserve funds, yet some lawmakers see large endowments and reserves (perhaps without a thorough understanding of how most funds are restricted) and demand to know why those funds can't be spent down to reduce tuition prices. And, even as they reduce per-student funding, many lawmakers continue to admonish colleges for "inefficiencies" and a "cost structure that increases without necessarily adding productivity or value."[2] Thus, boards can expect pressure to raise more unrestricted dollars to help fund gaps.

2. Tensions Regarding Endowment Spending

A key challenge for foundations is to establish a strategic asset allocation that can generate the returns necessary, at an acceptable level of risk. Historically, an average expected annual return of 8 percent (or more) on an endowment was reasonable, so a spending policy of 5 percent to 6 percent allowed adequate growth to maintain purchasing power and offset the effects of inflation.

However, many investment experts today question whether average returns at that level can reasonably be expected to continue. If a foundation doesn't feel that its endowment will achieve an 8 percent return, then it might consider reducing the spending rate. But this may be counter-productive at a time when colleges need greater funding support. (Moreover, many potential major donors are wary of endowment-giving when only a very small percentage of the gift is spent each year; such donors would be less likely to give.)

Complicating matters, some lawmakers want to propose a *requirement* that public charities pay a minimum annual amount from their endowments (such as the 5 percent now required of private foundations). But, depending upon market conditions, such a mandate could hurt foundations' ability to maintain the long-term purchasing power of endowments. (See "Intergenerational Equity" on page 18.)

3. Shifts in Major Donor Motives (i.e., 'Venture Philanthropy')

Historically, donors have given to alma maters out of a sense of gratitude or obligation to "pay back" for the education that made them so successful, often starting with small amounts and increasing to major donor status over the years. But many of today's donors are different. Some "mega" donors give because they want to solve a significant societal problem. Bill and Melinda Gates are perhaps the most visible of such "venture philanthropists." Whether their specific cause is to help students from community colleges more easily transfer credits, or to find a cure for cancer, or to end hunger, or another major challenge, these donors want to see evidence of measurable impact. They expect a greater degree of involvement and want to see more than a report on the amount of their giving spent on the intended purpose. They expect to see real progress toward solving the problem and tangible "return on investment"—or their gifts will go to other organizations instead. Such partnerships can be exciting but also risky if challenging goals cannot be met to donor satisfaction. Boards must always make sure the goals of major donations adhere to the host institution's mission and are handled in a way that is accountable to the public interest.[3]

4. Increasing Nonprofit Competition

The number of nonprofit organizations is growing.[4] This creates two challenges: 1) increasing competition for donors' dollars and 2) a growing demand for experienced fundraisers. Retention of the most

[1] According to a Council for Aid to Education's Voluntary Support of Education Survey, in FY2012, 502 private institutions of higher education reported that 12.1 percent of the contributions they received were unrestricted. In contrast, 519 public respondents reported that only 3.4 percent of their contributions were unrestricted. See cae.org.

[2] *AGB Top Public Policy Issues*, "Mixed Messages from Policy Makers." AGB, 2013, p. 6.

[3] AGB's "Statement on External Influences on Universities and Colleges" (AGB, 2013) describes some of the challenges associated with such gifts. See: www.agb.org/statements.

[4] Between 2001 and 2011, the number of nonprofits increased 25 percent (from 1,259,764 to 1,574,674) according to the Urban Institute.