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**CLIENT ADVISORY**

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# Foundation Payout in a Down Economy

*In this topsy-turvy economy the assets of nearly every foundation and charitable institution have decreased in value. The current forecast is for a difficult season for nonprofits and those they serve. With cities and states cutting their budgets, vulnerable populations, often very near to hunger, homelessness, or inability to obtain needed basic services, may face the worst situation in many years. As advisor to donors and foundations, and friend to nonprofit organizations, GMA is being asked to respond to some basic questions.*

Donors are asking….

**With the current value of my private foundation's assets down, will I still have to meet the same pay out amount?**

Private foundations are required by law to distribute an amount each year based on five percent of the average value of their net assets. If a foundation has paid out more than was required during the previous five year period, it may have a carry-forward (shown in Part XIII of the 990-PF form), all or a portion of which it may count toward the current year's mandatory payout.

Some private foundations do not hold significant financial or other assets, but instead receive revenue from their donors on an annual basis, and pay that revenue down in the same year. Foundations configured in this way, sometimes called pass-through foundations, usually have a lower payout requirement, because the five percent formula is based on the average of funds they held between receiving and granting the funds. These foundations may have greater flexibility in fine-tuning their giving to the economic downturn. However, giving will still be based on what the donor is able to pass through.

**What if I don't have enough cash in the foundation's accounts to meet my mandatory payout?**

As painful as it is to think about selling securities or other assets into a down market, there may be no choice. The IRS penalties for not meeting the mandatory payout are severe. For this reason, many foundations choose to "get ahead" of their mandatory payout, granting out more than required during favorable times, in order to build a cushion for years when their cash position leads them to a decision to give less.

**If our foundation has funded long-term projects, and the expected other sources of support do not materialize for the grantee, is there a chance of non-performance?**

This will surely be a difficult time for nonprofit organizations, and it is definitely possible that other sources of earned or grant revenue that they had hoped, or even expected, to apply to a project may shrink or disappear. There have already been significant budgetary cuts on state and city levels. Foundations would be wise to understand this degree of increased financial risk and to work constructively with grantees to assure realistic projections and appropriate operating plans.

**With nonprofits facing difficult financial times, and decreases in funding from corporations, individuals, and governments, is this a time to be giving more than the foundation is required to spend?**

This is a matter of personal giving philosophy and of balancing comfort and prudence. It is certainly true that an economic slump is hardest on the disadvantaged and will be difficult for the organizations that serve vulnerable populations. As a result, increased giving in down times, if it is well targeted, can have greater impact than during more prosperous periods.

**There is so much terrible human impact visible from the economic situation in my region; is this the time to consider emergency relief grants?**

Emergency relief is definitely needed, and many agencies, such as food pantries and fuel assistance providers, are soliciting extra contributions and grants at this time. Donating to these causes is a good citizen activity, but donors should also consider how much they want to stray from their core ongoing mission in order to provide emergency support.

**Assuming that we have less to give during the next year or so because of the economic downturn, how can we assure the maximum charitable impact?**

If you have less to give, the choices among applicants who can make a good case for needing funds will be difficult. While there is no easy answer, we recommend sticking with your core strategy, or further honing it if possible. If you are a long- term supporter of a certain nonprofit, this is not the time to back off. If possible, resist the temptation to make each grant a bit smaller. While it avoids some of the hard choices between grantees, the approach of “going small” can fragment your grants program, often failing to meet grantees’ needs. At the same time, your foundation administrative costs remain, because making small grants is no less work. Hard as it is, we recommend holding your grant size. If you can re-affirm your own mission, and analyze grants in that context, you will continue to support causes of primary importance to your trustees, and you will have a stronger portfolio of grants when the economy turns back upward.

Grantees are asking….

**Will major foundation funding decrease? Dry up?**

Funding will not dry up. Foundation funds are likely to go down, but not necessarily this year. Since private foundations that have assets have a mandatory payout based on 5% of last year’s average asset value, their decreased spending may lag the recession. However, with those foundations that spent ahead of the required distribution or those that use donors’ annual contributions to pay out, rather than holding assets, the decline might be more immediate. Note that most corporate foundations are structured this way, so corporate foundation grants, along with contributions from corporations through their marketing efforts, will almost certainly decrease this year. Fiscally cautious donors and foundation trustees, looking at plummeting charitable assets that they must steward, are unlikely to increase or expand giving significantly at this time.

**Will decision times lengthen?**

We do not anticipate that greater competition or somewhat decreased funds to grant will lead foundations to significantly lengthen decision times. However, some foundations may consider deferring some proposals to later in their fiscal years in order to have a better sense of fiscal position.

**What will happen to regional or local philanthropic funds?**

Regional and local foundation funds are subject to the same influences as national foundations. At the same time, many organizations raise a significant part of local money from individuals. While we cannot predict behavior for certain, we anticipate that many families will need to lower their charitable budgets this year. This same trend may decrease the amounts available from United Ways or similar vehicles.

**Will there be fewer partnerships with for profit corporations?**

Unfortunately, most of the corporate citizens that are immediately affected by the current financial slump are banks, insurance companies, asset managers, etc., which are a major presence among corporate givers. We can expect to see these donations decrease. On the other hand, bank donations should not be confused with charitable funds managed by banks, which must continue to meet a mandatory payout under the law.

**Will donors be imposing new or different requirements on grantees?**

Donors have no reason to impose entirely new requirements. However, they can be expected to exercise vigorous due diligence, and scrutinize the feasibility of applicant and grantee plans. Donors will be asking applicants and grantees detailed questions about their budgets, especially if expansion is planned. Grantees would be wise to share contingency plans and fall-back positions with funders, especially if a project depends on raising significant new resources. In all cases, grantees and funders should be partners, communicating honestly about project development, financing, and risks, as well as grant contingencies and matches. In uncertain economic times, this honest dialogue is even more important.

**How should we incorporate the changes into our long term planning?**

Nonprofits should reaffirm and stick close to their core missions at this time. While you should not forsake any growth and should especially continue to pursue innovation, for most non profits, this is not the time for rapid expansions, major new capital campaigns or other efforts that require extraordinary infusions of new funds. Rather, use the current period to learn, plan, and solidify strategy so that when resources are more plentiful, your organization is ready for a burst of energy.