What is an Endowment?

- Short for “limited liability corporation,” an LLC is a for-profit business structure increasingly used by wealthy donors.
- Not tax-exempt, and funders don’t get a tax deduction for putting money into it.
- Flexible—allows owners to make tax-deductible contributions to 501(c)(3)s as well as engaging in political giving and for-profit impact investing.
- No payout requirements.
- Can offer donors more privacy around their giving.

An endowment is a pot of donated money that is invested to create a reliable stream of annual income for a charitable purpose. For nearly all private foundations, endowed funds are the primary sources of their giving. Some public charities also have endowments, most commonly in the arts and in higher education. Each organization with an endowment typically has customized policies that guide how their endowment is invested, how much should be withdrawn and when, and how the money is spent.

What are some examples?

Say a donor wants to support a scholarship that will be given out every year. They will endow the scholarship by making a restricted endowment gift today. The funds will sit in an invested account held by the institution that gives out the scholarship. The value of the fund will most likely grow over time, as the investment earns interest and dividends. Each year, only the cost of the scholarship will be paid out. The rest continues to be preserved or to grow, so that there is money for that scholarship every year into the future.

A university or hospital’s endowment is the (often huge) collection of funds that have been donated to ensure the long-term financial stability of the organization. Donors make endowment gifts, and the bulk of the money they contribute sits in invested accounts. Only an agreed-upon portion of the investment income or the fund’s value is withdrawn each year to pay for the university or hospital’s expenses.

Are all endowments permanent?

The conventional endowment is set up to exist in perpetuity (i.e., forever). This is where "you never touch the principal" (the money that was donated to the endowment), and only the investment income (or a portion of the income) is spent. Depending on investment returns and the rate of spending, this usually results in a pot of money that grows bigger over time.

There are also term endowment funds, which are designed to exist for a specific period of time (or term). In this case, the investment and spending policies will be designed so that money is spent for charitable purposes faster than the endowment fund can grow. The principal will be touched as the endowment is intentionally spent down.

Are there special rules for endowments?

Endowment gifts come with a lot of restrictions that are laid out in the gift agreement. Endowment gifts are often restricted not only in the sense that they are endowment gifts—that is, most of the gift must sit in an invested endowment account, and only an agreed-upon portion can be spent by the nonprofit in any given year—but also in the sense that the spending often is restricted to a particular program or project. While some endowment gifts are made for general operating support, many are intended to endow a particular program or project in perpetuity, like the scholarship described above.

And then there's the legal aspect. While there is not a national U.S. law governing endowments, the Uniform Prudent Management of Institutional Funds Act guides how endowment funds can be invested and spent in most U.S. states. Beyond that, organizations with endowments typically have their own customized investment and spending policies that guide how an endowment fund is invested, what kind of withdrawals can be made and when, and how the money can be spent. These policies specify things like a target rate of return and whether or not to put some or all of the endowment funds into impact investments that advance the organization's mission.

Private Foundation Endowments

A private foundation is established when a person or family sets aside a pot of money to be used for charitable contributions. This pot of money—a tax-deductible contribution by the founder or founders—is the foundation's endowment. The founders can add to it over time if they choose. The foundation's endowment is invested, and the foundation is required to pay out at least 5% of the value of its assets in the form of grants and operating expenses each year.

Public Charity Endowments

Public charities, or what you think of when you think "nonprofits," can also have endowment funds. These are funded by dedicated endowment gifts from donors. For a nonprofit, an endowment can provide financial stability in the form of reliable annual income, so the organization doesn't have to fundraise its entire operating budget every year. It's rare for small or emerging nonprofits to have endowments, but very common for larger and established organizations like universities, hospitals and museums to have them. In fact, establishing an endowment is a big step toward the long-term financial stability of an organization.

You may also want to check out:

- What do the terms "spend down" and "in perpetuity" mean?
- The Surprisingly Complex ABCs of Endowment Funds
- A Close Look at the Law Governing Endowment Funds