

# Assisting Community Foundations with Financial Stewardship: Lessons learned

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## **Introduction to Lessons Learned Series**

*Michigan has been intentional about growing community foundations since the late 1980's. Local efforts have been supported by the Council of Michigan Foundations with funding from the W.K. Kellogg Foundation. FERA (Formative Evaluation Research Associates), an independent evaluation group, has documented growth, identified supports and obstacles, and developed lessons learned across multiple statewide initiatives designed to support community foundations. This document is part of a larger set of lessons learned about community foundation growth. To learn more about a conceptual framework and methods for developing lessons learned see Evaluation Overview found in "Introduction" on [www.GrowingCF.org](http://www.GrowingCF.org).*

## **Background**

The Council of Michigan Foundations (CMF) received a W.K. Kellogg Foundation grant (1998 - 2003) to enhance the level and types of technical assistance it provides to community foundations. Designed to serve Michigan community foundations with under \$20 million in assets, this grant and its evaluation are part of a much larger effort—Michigan Community Foundations' Youth Project—to build community foundation capacity and involve youth in philanthropy.

The enhanced technical assistance grant provided on-site mentoring, planned-giving seminars, a technology consultant, a Building Community Foundations training series focused on communication and marketing, financial services consulting and technical assistance related to spending policies in a down market. This document focuses on lessons learned related to financial services technical assistance. First, financial investment technical assistance services (1998 – 2001) are described followed by relevant outcomes and lessons learned. Then, technical assistance activities related to spending policies in a down market economy (2002 – 2003) are described and are followed by relevant outcomes and lessons learned.

## **Financial Investment Services (1998- 2001)**

CMF contracted with a national investment evaluation group to provide technical assistance to a group of 33 community foundations with less than \$20 million in assets (1998 – 2001).

Phase I of this project (April 1, 1998 to June 30, 1999) provided the following services:

- ◆ Education regarding asset allocation and adoption of a formal target asset mix
- ◆ Spending Policy analysis and recommendation for adoption of a formal policy
- ◆ Development/review of investment policies and recommendation for adoption of a formal document
- ◆ Investment performance analysis for the year ending December 31, 1998.

Phase II of the project (July 1, 1999 to March 31, 2001) focused on the following areas:

- ◆ Evaluating current investment managers and making recommendations
- ◆ Reviewing investment fees and making specific recommendations
- ◆ Ongoing investment performance analysis for the years ending December 31, 1999 and 2000.

Technical assistance delivery methods included: introductory meetings with each participant, four regional training sessions, on-site visits, and telephone conference calls.

## **Outcomes**

Thirty-three out of 42 small and emerging community foundations were provided technical assistance related to their financial operations. Outcomes included:

- ◆ Increased knowledge about investment and spending policies, and effective asset allocation
- ◆ Affirmation, revisions and adoption of investment and spending policies

- ◆ Review of asset allocation comparing individual community foundation performance reports and general recommendations made by the consulting firm
- ◆ Affirmation, revisions and adoption of community foundations' asset allocations
- ◆ Increased knowledge about the role of the investment committee and investment managers' roles

### **Investment and Spending Policies**

When the effort to support community foundation financial operations began, fully one-third of the participating community foundations did not have spending policies in place and did not have the recommended mix of assets. Out of the 33 community foundations participating almost all have implemented the consulting firm's recommendations including target asset mixes, revisions to investment policy statements, implementation and/or revisions of spending policies (see Table 1). The consulting firm wrote:

*“Most of the foundations either adopted a new Investment Policy Statement (IPS), or revised their existing IPS to better reflect the organization's investment objectives. Several community foundations adjusted their spending policies to reasonable levels after reviewing [our] research on asset allocation and spending policy. A few modified their calculation method to lower the volatility in year-to-year distributions.”*

Investment returns have not increased as hoped for because of the sharp downturn in the economy. One would expect that when the economy turns around community foundations are poised for increased asset returns.

**Table 1**  
**A Comparison of Community Foundations with Target Asset Mixes, Investment and Spending Policies 1998 to 2000**

	<b>98 (N=29)</b>	<b>99 (N=29)</b>	<b>00 (N=33)</b>
Target Asset Mix	Yes (20) No (9)	Yes (25) No (4)	Yes (30) No (3)
Investment Policy Statement	Yes (25) No (4)	Yes (24) No (2) In process (3)	Yes (32) No (1)
Spending Policy Statement	Yes (19) No (10)	Yes (22) No (7)	Yes (30) No (3)

### **Asset allocation and Performance Measurement**

Changes in asset allocation were made based on individual community foundation risk tolerance and desired spending policy percentage and general recommendations made by the consulting firm. The consulting firm provided the community foundations with three annual performance reports. These reports measured the performance of the overall portfolio, as well as the individual managers, versus the appropriate benchmarks. This analysis helped the investment committees understand what worked well and where improvements needed to be made.

The consulting firm wrote:

*“Several community foundations had not diversified into small cap and international stocks. We demonstrated the risk/return benefits of diversifying into these asset classes. Some community foundations were invested only in growth stocks or only in value stocks. We provided studies to demonstrate how having exposure to both types of styles reduces a foundation’s volatility. We also explored the advantages and disadvantages of index funds versus actively managed portfolios....Many of the participating community foundations adjusted their asset allocation mixes to improve the probability of exceeding their target returns.*

### **Education on role of Investment Committee and investment managers**

One of the purposes for contracting with an outside consulting firm was to increase small community foundation executive directors’ knowledge about the work of their investment committee. Executive directors were asked how much they knew about investment policies, spending policies, hiring an investment manager and investment committee members’ responsibilities before and after the technical assistance was

provided. Tables 2 and 3 reveal that most, but not all, executive directors become more knowledgeable in these areas.

**Table 2**

**Before** the consultant's visit/conference call/regional session how much did you know about:

	<b>A Great Deal (5)</b>	<b>Quite A Bit (4)</b>	<b>Some-thing (3)</b>	<b>Not Too Much (2)</b>	<b>Nothing At All (1)</b>	<b>Mean</b>
a. Investment policies	<u>3 (18.8%)</u>	<u>7 (43.8%)</u>	<u>5 (31.3%)</u>	<u>0 (0%)</u>	<u>1 (6.3%)</u>	<b>3.7</b>
b. Spending policies	<u>4 (25%)</u>	<u>7 (43.8%)</u>	<u>3 (18.8%)</u>	<u>0 (0%)</u>	<u>2 (12.5%)</u>	<b>3.7</b>
c. Hiring an investment manager	<u>2 (12.5%)</u>	<u>2 (12.5%)</u>	<u>3 (18.8%)</u>	<u>7 (43.8%)</u>	<u>2 (12.5%)</u>	<b>2.7</b>
d. Investment Committee Member's responsibilities	<u>2 (12.5%)</u>	<u>5 (31.3%)</u>	<u>8 (50%)</u>	<u>0 (0%)</u>	<u>1 (6.3%)</u>	<b>3.4</b>

**Table 3**

**Now** (after the consultant’s visit/conference call/regional session) how much do you know about:

	<b>A Great Deal (5)</b>	<b>Quite A Bit (4)</b>	<b>Some-thing (3)</b>	<b>Not Too Much (2)</b>	<b>Nothing At All (1)</b>	<b>Mean</b>
a. Investment policies	<u>9 (60%)</u>	<u>5 (33.3%)</u>	<u>0 (0%)</u>	<u>1 (6.7%)</u>	<u>0 (0%)</u>	<b>4.5</b>
b. Spending policies	<u>9 (60%)</u>	<u>5 (33.3%)</u>	<u>0 (0%)</u>	<u>1 (6.7%)</u>	<u>0 (0%)</u>	<b>4.5</b>
c. Hiring an investment manager	<u>3 (20%)</u>	<u>8 (53.3%)</u>	<u>2 (13.3%)</u>	<u>1 (6.7%)</u>	<u>1 (6.7%)</u>	<b>3.7</b>
d. Investment Committee Member’s responsibilities	<u>6 (40%)</u>	<u>8 (53.3%)</u>	<u>1 (6.7%)</u>	<u>0 (0%)</u>	<u>0 (0%)</u>	<b>4.3</b>

Community foundations learned about the differences in the roles of the investment committee and investment manager. The consulting firm wrote:

*“Several community foundations allowed their investment managers to set asset allocation, investment structure, and even draft investment guidelines. We advised these Committees that they are responsible for establishing investment policies, including asset allocation, and monitoring the execution of these policies by the investment managers.”*

Community foundations either affirmed or changed their relationships with investment managers. The consulting firm wrote:

*“We assisted the community foundations in evaluating how their investment managers fit together within the overall portfolio. In some cases, we recommended changing managers.”*

Most community foundations found having financial technical assistance very valuable. It helped them review their current investments and asset allocations, educate their boards and provided them with a service that they could otherwise not afford. One person commented, “Their [the consulting firm’s] data creates an even playing field helpful to small foundations that want to work with local managers.” Another person said, “we used [the consultants] to help us educate the board to the importance of the spending policy, the logic behind it and implications of not adhering to it.”

Verbatim comments about why this service was valuable include:

- ◆ *[The consultant’s] insight and evaluation of our investment managers gave us confidence in questioning and measuring the outcomes of our investments. We became more confident in setting investment goals.*

*Their support for creating an investment policy established a sound basis for strategic planning and lively discussion about future goals.*

- ◆ *They helped us to improve our existing investment policy statement, giving more specific direction to our investment managers. This has given the Finance Committee more objective benchmarks to evaluate investment performance. Information brought by [the consulting firm] has initiated further discussion and evaluation of our current investment structure and if/how the structure needs to change as our foundation grows.*
- ◆ *Our donors can now be assured that the Foundation's assets are being managed in a professional manner and investment decisions are made based on prudent policies.*
- ◆ *In the past we did not have a clear investment policy - nor did the whole committee have a clear understanding of our investments and goals. With [the consultant's] help we have written policies and have a much better understanding.*
- ◆ *Because of their help we have moved to another level of understanding and functioning in this area. While we have a very good finance committee - after listening to the consulting firm, the Board along with the finance committee felt better about what they were doing and it reinforced their thoughts on where we should be going.*
- ◆ *Hiring managers -- we've never known how to fairly compare them, nor who's the best investment source for a particular asset class.*

By the end of three years almost every participating community foundation had implemented effective financial practices. Despite all of the changes made by community foundations, investment returns did not increase as hoped for because of the sharp downturn in the economy, but the changes have put them in a position to experience solid returns once the market rebounds. Nonetheless, having effective practices in place made it much easier for these foundations to implement national operational standards for community foundations.

## **Lessons Learned**

**A regional organization, like CMF, can create valuable efficiencies of scale by hiring a consultant to work with community foundations on their financial practices.** Few of the smaller community foundations could afford to hire the quality of

investment consultant that they had access to through the Enhanced TA grant. Consulting costs were lowered because of the volume of work offered.

**Financial technical assistance needs to be either focused on specific community foundation's needs or presented for learners with different levels of background and knowledge about investment (i.e., beginning, intermediate, advanced).** Regional sessions offered were too advanced for some and too basic for others.

**Conducting an inventory of what people already know can help focus the levels at which technical assistance is offered.** On-site visits and telephone calls allowed for the technical assistance to be customized to a specific community foundation's needs. For example, some investment committees were comprised of individuals with substantial knowledge and expertise in this area while other committees needed very basic information.

**Having an incentive encourages community foundations to make reviewing and/or developing financial policies a priority.** When participation in the Outreach to Professional Advisors Campaign was dependent upon community foundations meeting standards for community foundations (including financial management standards) this work became a priority for some community foundations that had not made it so previously.

### **Informed Spending Policy Decisions (2002 – 2003)**

In 2002, community foundations were struggling to minimize the impact of the down market on their grantmaking. Interviews with 20 community foundations revealed that 95% had funds below their original gifted amount. Community foundations needed to make informed decisions about whether, and if so how, to revise their spending policies.

In July 2002, CMF convened the Michigan Community Foundations Committee to formulate spending policy recommendations for foundations faced with endowment market values below the original gift amount. This meeting's primary purpose was to adopt a set of strategies aimed at addressing the growing concerns expressed by

community foundations over the decline in market values of permanently endowed funds and their ability to make grants from funds with market values below the original gift amount. From this committee meeting and a subsequent consultation with CMF legal council emerged a unified Community Foundation Committee position, which encompassed the following positions:

- ◆ The purpose of a community foundation is to preserve and grow permanent endowment funds over the long term
- ◆ The purpose of a community foundation is also to be responsive to community needs within the guidelines of the foundation’s board-approved policies.
- ◆ And when considering alternatives to a spending policy that prevents the spending of principal (UMIFA Total Return Spending Policy) from permanent endowment funds, community foundation boards should carefully examine the UMIFA Hybrid and Non-UMIFA spending policy options in conjunction with their governing documents, other policies, and their ability to meet future community needs.

UMIFA stands for the “Uniform Management of Institutional Funds Act.” This act, which governs the use of institutional funds, (e.g., endowments) was promulgated in 1972. In short, UMIFA sets forth management and investment guidelines for endowment funds held by foundations. When community foundations adopt a total return spending policy based on UMIFA, income including unrealized appreciation may be distributed so long as the market value of the fund is above the original gift amount. When a fund’s market value is below the original gift amount two options were suggested by the Michigan Community Foundations Committee. “A Hybrid Spending Policy which allows the distribution of ordinary income when no appreciation is available or the market value of the fund has dropped below the original gift amount. This type of policy is also governed by UMIFA and may result in spending below the original gift amount but only to the extent that there is ordinary income available for distribution.”<sup>1</sup>

The second option is a non-UMIFA total return spending policy. Under this policy “income available for spending is determined by applying a percentage...of the

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<sup>1</sup> Grant Distributions from Permanent Endowment Funds in a Down Market – Memo from the Michigan Community Foundation Committee October 30, 2002 p. 2

market value of the assets over a number of rolling quarters, regardless of the fact that distributions based on this calculation may dip into the original gift amount. This type of policy by its express terms is not governed by UMIFA.”<sup>2</sup>

Following the adoption of the positions outline above, CMF mailed a set of spending policy documents in October 2002 entitled, “Grant Distributions From Permanent Endowment Funds in a Down Market” to community foundations in Michigan (available at [www.cmif.org/documents/downmarket.pdf](http://www.cmif.org/documents/downmarket.pdf)). A chief aim of the dissemination of these documents was to clarify both spending policy options and the guidelines and legal limits set forth by UMIFA. Since Michigan is among the 47 states that have wholly or partly adopted UMIFA, a major portion of the documents mailed by CMF explained the legal limits that UMIFA places on community foundation spending of realized and unrealized appreciation and natural income. In addition to the spending policy documents, CMF also offered follow-up technical assistance calls in November and December 2002 to help Michigan community foundations implement policy changes.

## **Outcomes**

The primary purpose of providing technical assistance on spending policies was to ensure that community foundations had accurate information: 1) about spending policy options, 2) on the implications of selecting different options, and 3) to facilitate communication with current and future donors. Overall the sample of community foundations interviewed found the technical assistance valuable.

- ◆ Community foundations used the information provided to: 1) inform decisions about either affirming or changing their current spending policies; and 2) communicate about their spending policies to current and potential donors. Fully 68% of the interviewees (n=20) responded that they had (20% n=5) or were going to (48% n=12) make changes to their spending policies as a result of the technical assistance received.
- ◆ Community foundations used the information provided to review their fund agreements and investment policies.
- ◆ Efficiencies of scale were obtained by CMF contracting with legal counsel and obtaining high-quality information about what is legally possible.

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<sup>2</sup> *ibid* p. 2-3

- ◆ Providing information to the entire field ensured that every community foundation had the same information upon which to make decisions that made sense locally.

## **Lessons Learned**

These lessons learned are based on an evaluation of CMF's efforts to provide helpful information to Michigan's community foundations about spending policies in a down market in 2002. FERA interviewed a sample of executive directors from 20 community foundations in 2003 to obtain feedback about the usefulness of this technical assistance, and to understand the value of the information provided to community foundations. Three key lessons were learned.

**Providing legal information that helps community foundations make decisions about policies and procedures is a valuable role for a support organization to play.** A support organization can create efficiencies of scale and can ensure that a group of community foundations receives the same information. CMF sought legal counsel on a wide range of financial policies and related issues. Community foundations valued this information and were able to make informed decisions about affirming or changing their spending policies and providing accurate and helpful information to donors.

**Technical assistance must be able to be responsive to community foundation needs. Social, economic and political changes affect community foundations and the work they do. Assistance in navigating changes is both valuable and cost effective.** Technical assistance was provided about spending policies and almost all (30 out of 33) reviewed and/or revised existing policies or implemented policies for the first time. Then the market took a downturn. Community foundations needed advice on how to modify their spending policies, given that almost everyone had funds below the original gift amount. CMF sought legal advice, prepared materials and held conference calls to help community foundations make better-informed decisions.

**Technical assistance can help community foundations understand the reasons behind policies—what purpose they serve, and why they are important.** In the case of investment and spending policies, when Michigan began the process of implementing standards even the smaller community foundations were able to meet Michigan's operational standards for community foundations within a short time frame—

18 months—because financial and other effective practices had already been implemented.