

Planned Giving News

SECOND QUARTER 2006

WHAT YOU GET IS NOT ALWAYS WHAT YOU KEEP

by Maye Albanez

In a recent newsletter we discussed the strains many non-profit organizations (NPOs) are experiencing with their charitable remainder trusts due to the cyclical nature of the securities markets. Over the past several years, portfolio market values have not grown enough to offset payouts to beneficiaries and expenses. The result is many of these trusts are below their original gift value today.

Some of these situations were clearly aggravated by the characteristics of gifts accepted and payout promises made to donors during and at the end of the last bull market. Our previous newsletter offered possible solutions to existing situations. Going forward, we believe a thoughtful and structured gift acceptance policy can help mitigate the magnitude of many of these problems in the future.

Given the limited scope of this article, we will focus on two critical issues we believe NPOs must evaluate prior to accepting gifts from potential donors. The first mandates that NPOs retain the right to say no to gifts which are not in their best interest. The second mandates that NPOs, through their representatives, effectively disclose not only the clear advantages of life income gifts to donors, but more importantly, that they disclose the inherent risks as well.

LEARN TO SAY NO...

If after careful analysis the gift does nothing to potentially further the mission of the NPO, the gift should be politely declined. Some of the most common mistakes are the result of having accepted the wrong gift. To help you avoid these situations, we recommend the following:

Keep your eye on the remainder value, which is not necessarily the current value:

While the size of a gift is of course important, a sound policy must address the minimum gift a charity is willing to accept in terms of its expected remainder value rather than its value today. The NPO must take into consideration the additional potential costs of the gift, and be able to predict within

reason the life expectancy of the agreement. Some gift agreements may make perfect sense if they are expected to last five years, but they make no sense at all if the expected life is twenty years. How much will it cost to insure, store, secure, maintain, fix and manage the asset for that number of years? Some costs are fixed and must be paid, irrespective of the size of the assets.

Other than providing for the income beneficiary, the NPO has a duty to watch out for itself. Servicing the donor may lead to great relations, but at the end of the day, if it does nothing to further the mission of the NPO, it must learn to say no to the gift. Educating the donor as to why their gift is not a good fit may ease the difficulty of this conversation and generate a discussion surrounding other assets available for donation.

Exercise caution prior to accepting overpriced assets or those with limited liquidity:

If the value of the gifted assets is overstated at the time the gift is made, or if gifted assets have limited liquidity, the investable proceeds following the sale can be substantially lower than the original gift. The result can be less principal to reinvest and a reduced chance to earn the payout promised to a potential donor. Real estate, thinly-traded stocks, restricted stocks, closely-held stocks, etc. can fall into this category. Proper disclosure and education of a prospective donor prior to accepting the gift will result in realistic expectations on their part. The last thing NPOs want or need are unhappy donors.

Avoid small gifts with limited diversification options:

Small gifts can be difficult to diversify at a reasonable cost and may be better suited to pooled funds rather than individual charitable remainder trusts, if at all. The burden of fixed costs (e.g. tax returns), irrespective of gift size, is a critical factor to keep in mind. Establish minimums for pooled gifts and for separate trusts which, ideally, relate to expected charitable remainder values.

continued on insert back

**PROPER DISCLOSURE AND EDUCATION OF A PROSPECTIVE DONOR PRIOR TO
ACCEPTING THE GIFT WILL RESULT IN REALISTIC EXPECTATIONS ON THEIR PART.**

THE CHARITABLE ORGANIZATION MUST MAKE SURE THAT ALL POTENTIAL DONORS AND THE CHARITY'S STAFF ARE EDUCATED ON THESE IMPORTANT DIFFERENCES BETWEEN THE INTERESTS OF THE INCOME AND REMAINDER BENEFICIARIES, SO THERE ARE NO DISAPPOINTMENTS DOWN THE ROAD.

continued from insert front

DISCLOSE THE RISKS BEHIND LIFE INCOME GIFTS

It is easy to get excited discussing the advantages of life income gifts with a potential donor. It is extremely important the same discussion include potential risks of the same gifts as well. It is generally better to under-promise and over-deliver than the other way around. An unhappy donor is the last thing any NPO needs, so to prevent these unfortunate situations, we recommend the following:

Limit payout promises to sustainable investment returns:

Consider full market cycle returns and not the high-return environment in place when the gift is made. Educate potential donors on best and (more importantly) worst case scenarios. Illustrate what can happen to the value of the underlying portfolio in a poor market when payouts and expenses must be paid, irrespective of market conditions. If we learned anything from the last several years, we should have learned that.

Aggressive payout and investment return expectations on the part of donors must be carefully downplayed. Prior to offering a high payout, consider the life expectancy of the agreement. Eight to ten percent payout in today's environment may be acceptable for a trust with a life expectancy of three to five years. Five percent, and possibly six, may be more appropriate

if the NPO expects to retain reasonable value upon the trust's maturity. The ideal donor should have a charitable intent, and some tie to your organization, and not simply be looking for the best deal in town.

Learn from donor expectations on gift annuities:

Often times, when charitable gift annuity contracts are signed between donors and NPOs, both parties go into the arrangement expecting the charity to retain about half of the original gift when the gift matures. Interestingly enough, that same expectation does not hold true for CRT gifts. Instead, donors seem to expect steady or increasing payouts from year to year.

It should be the NPO's obligation to disclose to the donor that the market value of the gift and the payout amount may decrease over time rather than continue to go up each year. Depending on the vehicle used, the higher the payout rate, the more likely income distributions will decrease over time.

Donors and trustees should understand investment of charitable gifts is different from investment of endowments:

Charitable remainder trusts (CRTs) serve two distinct masters—income beneficiaries and charitable remainder beneficiaries. Endowments, on the other hand, serve only one master. Income beneficiaries are most concerned with the periodic payouts

from CRTs; NPOs, on the other hand, are most interested in the ultimate values of the trust corpora. The result is two differing investment objectives. In addition, CRTs will eventually terminate while endowments are perpetual in nature. As a result, endowments can generally afford to take greater investment risks. Lastly, CRTs are often smaller in terms of market value so their size can limit diversification potential, especially in terms of asset classes.

The charitable organization must make sure that all potential donors and the charity's staff are educated on these important differences between the interests of the income and remainder beneficiaries, so there are no disappointments down the road.

We hope these considerations help you get started with a reasonable gift acceptance policy, and help keep you out of trouble with donors and people with oversight responsibility over these gifts. The intent of these guidelines is not to scare you, but to help you maintain happy donors. Time has shown us that happy donors are often repeat donors, and that is good for any NPO. If you address these important issues upfront, you will have a win-win situation.

The goal is not how many gifts you log onto the books of your non-profit organization, but how much you retain for your organization once you fulfill your promise to your loyal donor. In the end, that is the only score worth keeping. **\$**

Pasadena 200 S. Los Robles Avenue, Suite 320, Pasadena, California 91101 P 626-792-2228 F 626-792-2670
Huntington Beach 16902 Bolsa Chica Street, Suite 204, Huntington Beach, California 92649 P 714-846-2851 F 714-840-5212
Evergreen P.O. Box 2945, Evergreen, Colorado 80437 P 720-746-1244 F 720-294-9896
www.clifford1915.com