

# Endowment funds: An introduction

## What is an endowment fund?

An endowment fund is property which a charity must retain and invest to generate an income.

## Different types of endowment

There are two main categories of endowment fund:

**Permanent endowment** where the trustees may spend the income generated from the investment of the capital but cannot spend the capital itself.

**Expendable endowment** where the trustees have power to spend the capital by passing a resolution to convert it or part of it into income.

It is also possible to have a **hybrid** form of permanent and expendable endowment where the trustees have a restricted power to spend capital in certain prescribed circumstances.

## How do I know if my charity has an endowment fund?

The starting point is to review the documents establishing and/or governing the fund (e.g. a Will, deed of gift or trust deed) to identify any relevant restrictions. It is not always easy to ascertain whether property is held as an endowment as the term itself is rarely used in governing documents and so it is common for unrestricted funds to be incorrectly designated as an endowment, or vice versa.

## How do I create an expendable endowment fund?

An endowment fund can be established in a number of different ways including by a charity formally declaring a trust in accordance with a written declaration of trust. This approach provides a clear structure for the endowment fund and, provided the declaration of trust is properly drafted, ensures that the charity has all the powers it needs to deal with and invest the endowment fund.

## Can we spend expendable endowment?

An expendable endowment fund is a flexible vehicle. The capital can be retained and invested but the trustees can also decide at any time to spend it in accordance with the fund's charitable purposes.

## Can we spend the permanent endowment?

The starting point is that the capital of a permanent endowment fund is locked up and cannot be spent. This source of income can provide a charity with a degree of financial security but it can also cause difficulties, for example, if the charity has cashflow issues or there are more effective ways to use the funds. In these circumstances, the trustees may be able to use statutory powers to release the whole or a portion of the capital. There are certain conditions which must be met and Charity Commission consent will be required if the market value of the fund is over £25,000.

## Can we borrow from the permanent endowment?

A charity can borrow up to 25% of the total value of a permanent endowment fund without the need for Charity Commission consent, provided the trustees are satisfied that the charity has arrangements to repay the borrowing within 20 years. It's a useful option if your charity has a short-term need for funds but ultimately wants to preserve the capital of their permanent endowment. If your charity wanted to borrow a larger amount, it would need authority from the Commission.

**Permanent endowment and social investment**

If your charity has adopted a total return approach, the trustees can separately resolve to use some or all of the permanent endowment to make social investments that are expected to provide a negative or uncertain financial return. The charity can then make such investments as long as they expect any losses to be offset by gains as part of the total return from the fund.

Difficulties caused by these rules, for example, in years where interest or dividend income are low and capital growth is high, can be overcome by adopting a ‘total return’ approach. This allows a charity to spend from all investment returns, whether received as income or capital gain. The adoption of a total return approach involves a series of steps which are prescribed in regulations.

**Investing permanent endowment**

If your charity has permanent endowment, specific investment rules apply. It must be invested in a way which balances the interests of current beneficiaries, through income return, with the interests of future beneficiaries, through future growth.

**Get in touch**

Should you have any questions or would like to find out more about how we can help, please get in touch.



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