

## CONSIDERING

*the* QUESTION  
of PERPETUITY

By Vincent Stehle

*A threshold decision for the donor of virtually any kind of family fund involves its duration: Will it last for a term of years or in perpetuity? This decision directly affects investment strategy. Trustees of a foundation destined to spend out by a certain date will likely emphasize current income and liquidity, while those governing a perpetual foundation will likely want long-term income plus growth in principal. Sound arguments exist for both approaches. Before a family can choose a prudent investment policy for its foundation or fund, it must answer a fundamental question: Will this fund exist in perpetuity or will it be spent out of existence in a set number of years?*

**A**LTHOUGH THERE IS SOME DEBATE within philanthropy about the question of perpetuity, in the end no single correct approach is right for all donors. The decision to create a foundation for the ages or for the moment is a highly individual choice. It should be guided by the philanthropic goals laid out by donors and their families.

The bottom line is that some charitable purposes require urgent attention and others will plague society for many generations. Philanthropic resources should be available to deal with both types of issues. Fortunately, foundation law currently permits donors to choose freely which approach suits them best.

Many factors influence why donors endow their foundations in perpetuity. For many, foundations stand as legacies to future generations. For others, foundations can serve as tools to engage subsequent generations in a family's philanthropy. Perhaps for most, foundations are created in the knowledge that most charitable needs persist over many generations. Since the beginning of the twentieth century, foundations have been regarded by philanthropists as the best way to develop long-term solutions to vexing social problems.

The foundation that is intended to exist in perpetuity needs to steward its resources carefully, paying out a conservative amount each year—at least 5 percent of total assets as required by law—and investing in securities and other financial instruments that will grow over time. By contrast, the fund that is meant to spend itself out of existence in a given period of time is likely to distribute a much higher proportion of its assets each year, and would therefore be more inclined to hold a portfolio with a greater emphasis on liquidity.

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## A DONOR CHOOSES TO SPEND OUT

For more than a decade, the Beldon Fund—worth about \$10 million in 1997—was a modest supporter of grassroots environmental activism. But in 1998, the fund saw a dramatic infusion of assets, growing to about \$100 million when the founder's family business, Steelcase, went public.

At the same time, Beldon President and Founder John R. Hunting announced a policy change that would result in an even more dramatic increase in the foundation's activity. Rather than maintaining the newly rich foundation in perpetuity, Hunting announced that Beldon would spend out all its assets within a decade.

Hunting cited several reasons to justify his decision, including:

- His belief that all foundations should have a limited term of operation;
- The vast new resources that the coming transfer of wealth would bring into philanthropy to replace current funds that choose to spend themselves out of existence; and
- His personal desire to see the results of his philanthropy in his own lifetime.

But his most important rationale, he said, was that, "Given all the environmental problems besieging our planet today, how can I not give away all the foundation's assets in the very near future?" Many people may ignore or deny the environmental disasters that threaten the planet, he concluded, "But those of us who fund environmental work know better. We know the enormity of the stakes. We know that time is growing short, and we know that we must throw all our forces into the fray now, before it is too late."

Half a world away, in Bavaria, Germany, the Wemding Hospice Foundation gives real meaning to the term perpetuity. Established more than 1,000 years ago, the foundation provides dwellings for the city's poor inhabitants. In the Bible, Jesus Christ is reported to have told his followers, "The poor you will have with you always." And the Hospice Foundation in Wemding takes the admonition seriously.

Although the two types of funds may be diametrically opposed in their operating philosophies, each approach is certainly justified. Choosing whether to set up a foundation in perpetuity depends very much on the philanthropic goals of the founders. Supporting AIDS research or fighting global warming might call for an immediate infusion of funds, while support for scholarships or providing healthcare and housing for the poor might be causes that would merit prolonged attention.

Setting up a foundation is only one approach among many options facing today's donors. In addition to giving cash gifts outright to existing charities, philanthropists can use many other giving vehicles to express their charitable intentions. Donors can establish charitable remainder trusts designed to benefit particular institutions when they die, or conversely charitable lead trusts, which provide an income stream to charity for a period of time, after which the principal in the trust reverts to an heir or group of heirs. Or they can simply establish bequests within their wills.

In the past decade, it has become popular to establish donor-advised funds and supporting organizations, two giving vehicles that give donors a measure of influence or control over the purposes of the funds, but which operate within an existing public charity. A donor-advised fund is a type of gift, commonly established at a community or other public foundation, that permits the donor to advise how the funds are spent. Likewise, a supporting organization is a quasi-independent entity, established for the benefit of a specific charity but operated under a separate board of directors. Donor-advised funds managed by commercial financial institutions, such as the Fidelity Charitable Gift Fund, have also grown quickly into major philanthropic forces.

For the most part, donors who choose to establish private foundations do so precisely because foundation status permits them to endow their giving in perpetuity. So it should be no surprise that most foundations are established with the intention to continue to operate indefinitely.

#### REVIEWING THE HISTORY OF THE DEBATE

The broad outlines of the debate over perpetuity reach back several centuries in European history and were sketched many decades ago in this country. The question of perpetuity is one of the most fundamental issues facing philanthropy and government regulators. Should private individuals be allowed to establish foundations that continue to operate long after the founders die, and should governments permit them to do so?

In the United States, the competing visions were laid out most emphatically by two of the titans of philanthropy: Andrew Carnegie and Julius Rosenwald. In establishing Carnegie Corporation of New York, Carnegie declared that future trustees should be permitted wide latitude in using philanthropic resources set aside by donors in perpetuity. By contrast, Rosenwald, a principal architect of the vast Sears, Roebuck retail empire, argued that wealthy donors should make sure that their philanthropies go out of business soon after they die.

In America, the question of perpetuity has largely been debated as a preference. The same cannot be said of all other countries. In England, for instance, more than four centuries ago, the battle lines were drawn more sharply. In 1535, King Henry VIII, seeking to restrain the power of the clergy and other vested interests, established a law that forbid trusts in perpetuity. Known as the Statute of Uses, the law required that all charitable trusts be liquidated within a generation after the death of the individual who established a trust.

That draconian approach has never been seriously considered in the United States, although it has been suggested by some foundation critics. Instead, for the most part, the debate has featured arguments between competing views, rather than calls for legislative mandates to enforce one view or another. Today, whether a foundation lives on in perpetuity is largely determined by the wishes of the founding donor.

### Kempner Fund Provides for the "Lean Years"

The Harris and Eliza Kempner Fund in Galveston, Texas, is one of a growing number of family foundations around the country that have recently celebrated their fiftieth anniversaries. Started in 1946 by five members of the Kempner family, the fund has grown from an initial asset value of \$38,500 to almost \$50 million today. The original donors, as well as the current trustees, recognized the value of a perpetual foundation, as described in the fund's 1996-97 biennial report:

The impetus for starting a foundation in 1946 came from the family's concern for the many local charities it supported. They realized that conditions that typically follow economic depressions and wars could affect their ability to support charities in time of greatest need. A philanthropic philosophy thus evolved: "Allow the more prosperous years to provide for the lean ones."

The fund has also served as a vehicle to promote the legacy of the family's giving, and to encourage future generations to continue the charitable work of the family. A matching gifts program established in 1963 has resulted in nearly \$1 million in contributions from family members to U.S.-based charitable organization that have been matched by the fund. The fund has also developed an advisory committee structure to involve members of the third and fourth generations of the family in foundation activities—as of 1997 almost 30 members of these generations had been included in this system.

### CARNEGIE'S VISION OF PERPETUITY

For many observers, Andrew Carnegie remains a preeminent figure in American philanthropy, not only because he gave away nearly all of his vast fortune, but also because he dedicated such a large amount of time and thought to his philanthropy. "The Gospel of Wealth," his seminal article that appeared in the *North American Review* in 1889, remains one of the most influential documents in the history of philanthropy.

In "The Gospel of Wealth," Carnegie argues that with great wealth comes a responsibility to spend it wisely, particularly in charitable affairs. "It is well to remember that it requires the exercise of not less ability than that which acquires it, to use wealth so as to be really beneficial to the community." Wealthy individuals should not simply leave their fortunes to charity, passively, but should be active participants in directing their philanthropy. Otherwise, he warns, "The man who dies thus rich dies disgraced."

Certainly, during his lifetime, Carnegie was an indefatigable philanthropist, especially in his immense efforts to erect—at a cost of \$56 million—public libraries: more than 2,500 throughout the world, including about 1,600 in the United States alone.

Taken out of context, Carnegie's "Gospel" is sometimes interpreted as a clear warning against establishing endowed philanthropy in perpetuity. But his views on the subject were more nuanced, as is evident from his later actions. In setting up Carnegie Corporation of New York in 1911 with \$125 million, he gave his trustees very wide latitude to adjust the work of the foundation to suit the times, stipulat-

ing only that the foundation “promote the advancement and diffusion of knowledge and understanding.”

“My desire is that the work which I have been carrying on, or similar beneficial work, shall continue during this and future generations. Conditions upon the earth inevitably change; hence no wise man will bind Trustees forever to certain paths, causes, or institutions. I disclaim any intention of doing so,” Carnegie wrote in establishing the Carnegie Corporation. “On the contrary,” he added, “I give my Trustees full authority to change policy or causes hitherto aided, from time to time, when this, in their opinion, has become necessary or desirable. They shall best conform to my wishes by using their own judgement.”

The wisdom of Carnegie’s approach is borne out in several examples of grant-making, where the foundation has had a profound impact on society in ways that its creator could hardly have envisioned many decades before.

In Carnegie’s day, books were the most common way to transmit knowledge. But a half century after his death, television had become the prevailing information medium. As a result of Carnegie’s broad mandate, the foundation was able to establish the Carnegie Commission on Educational Television, which led to the enactment of the Public Broadcasting Act of 1968 establishing the public broadcasting system. Likewise, the foundation helped to create the Children’s Television Workshop, home of Big Bird, Bert, Ernie, and other denizens of the popular children’s program, *Sesame Street*.

In developing public broadcasting in the United States, the Carnegie Corporation was able to carry out the broad goals set forth by its founder, but in ways that respond to the changing needs of different times.

Few foundations are as large or well known as the Carnegie Corporation. But many—if not most—foundations share its basic operating premise: An endowment is created with flexible guidelines that enable future generations to adjust programs to meet changing needs. The Commonwealth Fund, for example, was established by Anna M. Harkness more than 80 years ago, with the broad charge to enhance the common good. The fund carries out its mandate by focusing on improving health care services, especially to minorities, advocating for the elderly, and developing the capacities of children.

The Commonwealth Fund was created with a gift of \$10 million from Mrs. Harkness. With additional gifts from the family, and with the addition of the James Picker Foundation in 1986, the fund had grown to more than \$500 million in assets by the end of 1997.

John E. Craig, Jr., executive vice president of the Commonwealth Fund, suggests that donors have long understood that foundations can be most effective when they maintain a long-term involvement in program areas: “Early foundation leaders believed—and demonstrated—that their consistent engagement could add value to the work they sponsored. It was from this ethos that the concept of the perpetual foundation endowments emerged.”<sup>1</sup>

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Throughout the twentieth century, the practice of large-scale philanthropy through the establishment of private foundations has been dominated by funds that were set up to run in perpetuity. But the practice is not universal. Many small foundations go out of business each year, and a small number of larger funds spend out their assets from time to time. According to recent statistics, about 3,000 foundations commenced activity in 1998, while almost 500 ceased activities.<sup>2</sup>

#### FOCUSING ON THE PRESENT: JULIUS ROSENWALD

The most prominent critic of perpetual foundations was a philanthropist from an earlier era: Julius Rosenwald. Rosenwald, who rose to become chairman of Sears, Roebuck & Company, argued that philanthropists should direct their philanthropy in their lifetime and should ensure that their foundations cease operations within a generation. Writing to the trustees of the Julius Rosenwald Fund, he said, "I am not in sympathy with this policy of perpetuating endowment and believe that more good can be accomplished by expending funds as trustees find opportunities for constructive work than by storing up large sums of money for long periods of time. By adopting a policy of using the fund within this generation we may avoid those tendencies toward bureaucracy and a formal or perfunctory attitude toward the work which almost inevitably develops in organizations which prolong their existence indefinitely."

In its day, the Julius Rosenwald Fund became one of the largest supporters of traditionally black colleges and universities, among other causes. As one of the most progressive foundations of its era, the Rosenwald Fund had a lasting impact on the development of educational opportunities for African Americans, long before segregation was uprooted in America.

Rosenwald decreed that his foundation would cease operations within 25 years of his death in 1932. The trustees of the foundation exceeded his wishes, spending all of the fund's resources by 1948.

Rosenwald's heirs were not given perpetual control over his foundation. But they received a different legacy: his firm belief that foundations should not live on in perpetuity. His daughter, Edith Rosenwald Stern, and her son, Philip Stern, each established foundations that were set up to go out of business within a generation after their creation. The Stern Fund, created by Edith Stern, closed its doors in 1986, 25 years after its creation. And a separate foundation, the Stern Family Fund, endowed after the death of Philip Stern in 1992, is expected to spend its assets within a decade.

"We inherited this belief from my great-grandfather," says David Stern, son of Philip and president of the Stern Family Fund. "It has almost become Biblical in our family," he says. "Foundations become almost more interested in their own preservation than in doing the social change work they were set up to do," he argues, echoing the sentiment of his great-grandfather.



David Stern acknowledges drawbacks to shutting down foundations quickly. For one thing, foundations can be effective ways to transmit the values of philanthropy from one generation to another, bringing younger family members into the practice of giving. Moreover, because the family's philanthropy has been unstintingly progressive, he worries that few other funds will fill the same role when the Stern Family Fund goes out of business. "But these concerns do not change our fundamental belief."

Michael Caudel-Feagan, the part-time executive director of the Stern Fund, suggests that spending out all of a foundation's assets in a short period of time may be especially appropriate for smaller foundations. Operating a larger program for a short period of time, under the guidance of at least some level of paid staff involvement, ensures a more rigorous approach to grantmaking than might be possible without a staff, he says.

Several other large foundations have adopted a similar approach, spending all of their resources within a specific number of years set by the founding donors. Among them, the Lucille P. Markey Charitable Trust and the Aaron Diamond Foundation, both of which were devoted largely toward medical research, were the most notable.

#### THE DEBATE CONTINUES TODAY

In recent years, a conservative critique of foundations has focused its attention around the issue of perpetuity, fueled by a related concern: the question of donor intent. The basic argument is that large foundations tend to be run by professional staffs that are far more liberal than were the business tycoons who created the funds. By operating in perpetuity, these critics contend, foundations move inexorably toward more progressive policies, ignoring or purposely thwarting the interests and intentions of their donors.

Some proponents of this view would change foundation law to prevent such a shift and force all foundations to spend out their assets to prevent them from straying too far from the intentions of their founders.

To many foundation experts, this critique is misguided. "The ideology has been falsely put into this debate," says Vincent McGee, formerly executive director of the Aaron Diamond Foundation, the New York City foundation that spent more than \$200 million in ten years before closing its doors in 1996. Determining whether a foundation should exist in perpetuity is not generally a question of politics, he says, and in any event there is no single right way to spend out foundation resources. "I am not an advocate of spending out or setting up in perpetuity," says McGee. "It all depends on what you are trying to accomplish."

In the case of the Aaron Diamond Foundation, spending out made sense, in part, because of the work it chose to support. Under the leadership of Irene Diamond, the widow of Aaron Diamond, the foundation decided to focus a large portion of its resources on AIDS research, in the very early stages of the epidemic.

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Naturally, the Diamond fund was able to make a larger impact because it gave out a larger portion of its assets each year than it would have spent had it planned to live on in perpetuity. At a 1997 presentation sponsored by the New York Regional Association of Grantmakers, McGee observed, "Had we spent the IRS requirement of 5 percent, we would have had a budget, a grantmaking budget, of maybe \$6 million a year over the long run. In fact, we spent a little over \$20 million each year."

As is clear from McGee's observation, the question of perpetuity is intrinsically related to the issue of foundation payout, which has also become a controversial topic in recent years. Critics from the left and from the right have begun to call for higher rates of payout from foundations, particularly in light of the significant growth of foundation assets in the prolonged bull market of the late 1990s.

Conservative critics believe that, if foundations pay out a higher proportion of their assets each year, they will not live long enough to stray from the goals of their founders. And more liberal proponents of higher payout rates argue that the infusion of funds will help to boost resources available for the poor and for groups engaged in "social change" activities.

The National Network of Grantmakers, for example, is spearheading an effort to encourage higher payout rates among foundations. They argue in a recent briefing paper, "Paying out beyond the required minimum is one way to help realize the highest values of philanthropy and to direct more funding toward fostering social justice."<sup>3</sup>

Defenders of the 5 percent minimum payout rate, and the practice of not paying much more than the minimum, argue that over the long haul more money goes to charity when it is reinvested by foundations and paid out at the lower rate. The argument is essentially based on the power of compounding interest: when a foundation pays out a small portion of its assets and reinvests the remainder, the amount paid out will eventually be much larger. (See box on page 23 in Chapter II, "Developing a Spending Policy.")

For example, in the 1997-98 annual report of the Meyer Memorial Trust, established by retail magnate Fred Meyer, Executive Director Charles S. Rooks contends that the foundation has been able to increase the amount it gives away annually by keeping its payout down in earlier years. In 1982, when the trust had assets of \$120 million, it gave away less than \$6 million. Last year, with assets approaching \$500 million, the foundation was able to approve more than \$23 million in grants, all the while maintaining a payout of slightly more than 5 percent.

"From a short-range perspective, one could argue for spending more in the past because of the many unmet needs that existed during that period," said Rooks in the annual report. "From a longer view, however, it is clear that a foundation can contribute more by generating resources for the future as well as the present."



Although the swelling grant budgets of fast-growing foundations may be persuasive, some philanthropists remain unconvinced, preferring instead to set their foundations on a course to spend out in their lifetime, or soon thereafter.

Thomas E. Warth, whose Tew Foundation supports a range of international relief and educational activities, believes that today's needs are too great to wait for tomorrow's fatter grants budgets. "If children are at risk now, we need to deal with their problems now."

#### SUMMING UP: MATCHING PHILANTHROPIC GOALS AND FOUNDATION LIFESPAN

In the end, donors should set clear philanthropic goals for their foundations, and they should establish a timeframe that suits their goals. A compelling case can be made to spend out quickly, in the support of issues that require urgent attention. But an equally compelling case can be made for creating philanthropic funds that can build resources now and for the future.

The key reasons for spending out a foundation begin with recognition that the donor may want to effect change during his or her lifetime, not generations later. Many social problems demand urgent attention, and a donor can respond significantly by committing the full resources of the foundation to address the problem now. The donor can count on heirs to set up their own foundations and address problems of their generations. Foundations established in perpetuity may become self-justifying bureaucracies.

The key reasons for establishing a foundation in perpetuity begin with recognition of the power of compounding interest: A foundation established in perpetuity can grow its endowment to become larger and potentially more effective in bringing about lasting change. The donor can empower the trustees to alter the mission; thus ensuring that grantmaking will be directed to relevant social needs. Finally, many social problems are deeply seated, and only a foundation with a perpetual endowment can press reforms for many years in its effort to make a difference.

In either case, a proper investment policy requires a donor first to determine whether the fund should live on long after the donor passes away, or if it should spend out its assets in a limited number of years. Cash flow is more important for the foundation that is spending out, and income and growth are more likely the choices for the perpetual fund.

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