



Firm Foundations

A snapshot of how trusts and foundations are responding to the economic downturn in 2009

CHARITY
COMMISSION



The Charity Commission is the independent regulator for charitable activity. The aim of this research was to assess the extent to which some of the largest trusts and foundations in England and Wales were taking an actively strategic approach to their investments and delivery of aims (including grant-making), and to explore the relationship between the two within the context of the economic downturn.

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Foreword

A message from the Chair and the Chief Executive of the Charity Commission

Dear Reader,

Trusts and foundations play a unique and much valued role in today's society. Many have a long history, and date back to the Victorian era – a time of immense change, extreme need and a strong philanthropic impulse. Today their contribution to the wider charitable sector is key, and their role and influence at this time of economic downturn is crucial.

This report aims to provide a snapshot of the experiences of trusts and foundations as they face the future. Many of them have more robust finances than other types of charities, such as those which provide services. The income accrued from investments in the 'boom times' has served them particularly well and some are starting to spend from this pot without having to cut deeply into their capital base.

However, all the trusts and foundations interviewed for this research, were clear that the current situation requires a different response. In common with many other funders, these trusts and foundations are increasing their oversight of how effectively their money is used by recipient charities. They also appear to be more alert to the risks involved, with the vast majority of those interviewed telling us they now undertake closer scrutiny of the financial viability of organisations applying for funds.

What seems clear from this report is that the trusts and foundations interviewed saw the downturn coming, a perhaps natural awareness given that their primary income stream is investment-based. Their historically cautious approach to investment management also seems to have served them well, ensuring that most of them made the time and had the capacity to respond to sudden economic changes.

This is good news for the thousands of charities who rely on trusts and foundations for funds and for their millions of beneficiaries. Yet much depends on the duration of the current downturn. Whilst a clear desire was expressed on the part of trusts and foundations to protect the charities they fund from any drop in income they may be experiencing themselves, the report did not find evidence of any clear commitment to counter-cyclical funding. It may be that the full extent of trusts' and foundations' exposure to the downturn, and the wider knock-on effects, will not be revealed until next year or beyond.

In the meantime, the findings of this report will encourage trusts and foundations to consider how best to maintain their current relative stability in the years ahead.



Dame Suzi Leather
Andrew Hind

Chair
Chief Executive

1. Introduction

Purpose of the research

The Charity Commission commissioned this research in Spring 2009. The purpose of the research was to assess the extent to which some of the largest trusts and foundations were taking an actively strategic approach to their investments and delivery of aims (including grant-making), and to explore the relationship between the two within the context of the economic downturn.

The trusts and foundations interviewed

The research was qualitative in nature. In April 2009, in-depth interviews were conducted with nineteen primarily grant-making trusts and foundations (including the Big Lottery Fund which for the sake of simplicity has been categorised as a trust or foundation for the purpose of this research).

Whilst the majority of trusts and foundations are small, the interviews for this research focused on the largest grant-makers in terms of grant expenditure, but also included one smaller non-London based

trust/foundation, one community trust/foundation and one smaller corporate trust/foundation. The characteristics of the trust and foundations interviewed in terms of source of income, size of asset base and size of spending are outlined in Annex A.

As in other countries, the assets and income of the trusts and foundation sector in England and Wales is very unevenly distributed with a very small number of trusts and foundations commanding the vast majority of assets and income. This study deliberately focused mainly on those largest trusts and foundations whose spending makes up the majority of the total contribution (in terms of grant expenditure) of the trusts and foundation sector, and whose reach and impact across the charitable sector is therefore extensive.

The research provides a snapshot of trusts and foundations in April 2009. As discussed later on in this report, for a variety of reasons, trusts' and foundations' capacities may change in the coming months.

2. Background

There are an estimated 8,800 trusts and foundations in the UK giving grants and operating programmes across a range of charitable activities. Many are small in nature and income. However, the top 500 grant-makers are influential, spending around £2.7 billion (as at 2006) per annum, and providing around 10% of charity sector income.

Trusts and foundations play different roles in different fields. In medical research, for example, they are major players; in the field of health and social welfare they are, in financial terms, relatively minor players. Whether major or minor players, trusts and foundations are widely regarded as important in providing risk capital, research and development.

Endowed trusts and foundations are free to support the groups and causes that do not command popular and political support. Trusts and foundations are free to back ideas and activities that are genuinely innovative and thus carry a high risk of failure. Trusts and foundations can support the new and more risky activities – precisely those things from which change and innovation often flow. At a time when there is an increasing emphasis on the importance of tightly specified contracts and measurable outcomes, trusts and foundations, some argue, have never been more important. The health of trusts and foundations is therefore a matter of concern not only to the voluntary sector but to wider society.

Trusts and foundations typically, but not exclusively, rely on income from an endowment invested in the financial markets. Even those trusts and foundations that raise funds from the public or from business, and without an endowment, often depend on income from investment of those funds for their running costs. Corporate trusts and foundations, with no endowment, dependent on an annual allocation from a company, are also affected by that company's financial performance in that such allocations are usually calculated in relation to company profits.

When the wider economy and financial markets are suffering, it is reasonable to suppose that trusts and foundations will suffer too – at the very time when their support may be most needed. Despite this assumption, however, the reality is that the effects of the current downturn on the trust and foundation sector, and the broader voluntary sector, now and in the medium term are unknown.

The effects of an economic downturn on trusts and foundations and the effects on the wider voluntary sector, via grant-making, are two separate issues. Trusts and foundations may or may not suffer (due to their sources of income and investment policies) but it does not necessarily follow that these effects will be reflected, at least in the short term, in levels of grant-making to the wider sector. Existing data and experience from previous recessions are set out in Annex B.

3. Key findings

Calm, measured approach: Trusts and foundations report that they are taking a calm, measured approach and are actively working to make sure they are well prepared to manage the impact of the downturn. Whilst it has taken up a considerable amount of their time, they say they are 'holding their nerve' and don't see the downturn as a reason to panic.

Board discussion: All of the trusts and foundations interviewed said they had discussed the economic downturn at their board meetings and that there is greater involvement, questioning, and understanding of investment policies by all members of the Board

Closer scrutiny of grant applicants: Trusts and foundations demonstrated an increased interest in the effectiveness of the charities they fund. They are exercising more caution in how they manage the risks associated with grant-making. Sixteen out of the nineteen trusts and foundations interviewed reported that they were taking a more cautious approach, resulting in closer scrutiny of grant applicants' financial viability.

Consideration of impact of the downturn on charities: Trusts and foundations demonstrated that they are considering the impact of the downturn on charities in a range of ways, including:

- considering, where they tend to provide mostly project funding, more flexible approaches to supporting charities by funding some core costs too. However, at the same time they are clear that they don't want any funding of core costs to affect their support for funding innovative work by charities;
- demonstrating an awareness of the tough times that the charities they fund are facing, and expressing the view that it would be 'wrong to reduce funding in the face of increased need'; at the same time as demonstrating a hesitancy to commit to counter-cyclical funding arising from their commitment to preserving funds for future generations;

- expressing little enthusiasm for emergency funding to support 'ailing or failing organisations'. Of those interviewed, none had any plans to create special funds for downturn-hit charities; and
- Predicting that the impact on income had not yet taken full effect, and that the effect on grant-making beyond 2010 was uncertain.

Effect on income: Of the nineteen trusts and foundations interviewed, fifteen reported that they have experienced some decrease in income since Autumn 2008. However it is a small decrease (ten trusts and foundations experienced a drop in income of less than 10%), which they are managing proactively in order to avoid any impact on their grant-making. Only a small minority of those interviewed have experienced any significant decrease in income as a result of the downturn. At the same time four trusts and foundations had actually experienced some increase in income. Whilst the types of income (including return on investment) varied, and levels of reliance on investment income also varied, the picture at present is positive. However, a more uncertain picture was predicted for 2010 and beyond.

Use of pre-downturn investment return: The research provides evidence that trusts and foundations are well placed to manage the impact of the downturn. A view was expressed that returns on investments had been 'over-inflated' in the years leading up to the downturn. Some trusts and foundations say they are now beginning to spend from this pot of income and gains accrued from the years of investment growth

Use of Total Return approach: There is evidence that for endowed trusts and foundations, the ability to apply a Total Return approach balancing investment return and spending is helping to mitigate the impact of any decrease in income. (Total Return allows flexibility in managing invested permanent endowment where the trustee considers the overall return made, whether from income or capital gains or losses, and decides how much of that return to allocate to fund expenditure for that year). The ability to use a Total Return approach is viewed positively by the trusts and foundations interviewed.

Effect of foreign exchange rates: Trusts and foundations that fund international programmes expressed concern about the effect of foreign exchange rates, though some are taking steps to actively manage their exposure to exchange rate risks.

A number of positive effects arising from the downturn: Whilst expressing concern about the downturn, a number of positive effects were highlighted. Greater reflection of their collective Board responsibilities, and a questioning of values relating to social issues were cited. There was also a view that it may prompt greater collaboration between trusts and foundations, and a possible pooling of funding for some programmes of work that they support.

How the work of trusts and foundations might be encouraged and supported: A range of ideas and suggestions was put forward for how the work of trusts and foundations might be encouraged and supported. These included the promotion of further debate on a number of issues, including the pros and cons of decisions on 'spending out', and the need for endowed foundations to balance past, present and future commitments, as well as issues relating to taxation.

4. Analysis and conclusions

A strategic approach. There is clear evidence that the economic downturn has had a positive effect on governance in the trusts and foundations interviewed. All were taking an actively strategic approach to managing investments and pursuit of mission at this time.

Well prepared for an economic downturn. The trusts and foundations interviewed were well prepared for an economic downturn. The combination of investment expertise and a historically cautious approach to managing investments means that they have had the capacity to respond to a sudden change in the economy. Whilst some have experienced a decrease in income it has not (with one exception) affected grant programmes.

Informed and considered approach. There is clear evidence that some trusts and foundations could see the downturn coming, and that they are taking an informed and considered approach to managing its effects.

Sustained levels of grant-making at present. The research aimed to explore the extent to which trusts and foundations are actively taking a strategic approach to managing both investments and grant-making in order to deliver their mission. The findings clearly demonstrate that they are taking a strategic approach and are currently able to sustain their levels of grant-making.

Possibly too early to identify the full effects of the downturn. It may be, though, that it is still too early to identify the full effects of changes in the economy. The picture may change if the current downturn continues for several years; the real exposure may be not clear until 2010/2011 or beyond. If investment returns were to be exceptionally poor over a sustained period of time, a decrease in levels of grant-making is to be expected. There will, however, be different impacts/effects experienced by particular types of trusts and foundations depending, for example, on whether their main source of income is endowment, fundraising or corporate, or whether they are spending out or not. Consideration should be given to repeating this research each year, for at least the next two years.

A number of issues which merit further discussion and debate. The findings raise a number of issues and questions which merit further discussion and debate. These include, for example, issues relating to opportunities for collaboration and risk-sharing between trusts and foundations, and issues about social and mission-related investment. There are also questions about how to ensure that the large amount of expertise and good practice identified in the nineteen trusts and foundations surveyed, might be shared more widely with other parts of the charity sector. Consideration will be given to the best ways of facilitating wider discussion of the issues that are raised by this research. To this end, a joint seminar with the Association of Charitable Foundations is being planned for Autumn 2009.

5. Detailed findings

5.1 Effects of the downturn on assets, income and grant-making – The headlines

Table 5.1.1 *Effects of the downturn on assets since Autumn 2008*

Assets	No change	Change	Not applicable
Number of trusts and foundations	4	10	5

Of the ten foundations that reported a change in the value of assets, two had suffered a decrease of over 30%; four a decrease of 21-30%; one a decrease of 11-20%; and three a decrease of 10% or below.

Table 5.1.2 *Effects of the downturn on income since Autumn 2008*

% change	Number of trusts and foundations experiencing a decrease in income	Number of trusts and foundations experiencing an increase in income
0-5%	8	0
6-10%	2	2
11-20%	1	2
21-30 %	1	0
Over 30%	3	0
Total number trusts and foundations	15	4

Increases in income were mainly due to an increase in fundraised income, or an increased allocation from parent companies and donors.

Table 5.1.3 *Effects of the downturn on grant-making expenditure in 2009*

Effects on grant-making	Increase	Decrease	No change/marginal change
Number of trusts and foundations	3	2	14

5.2 The story beneath the headlines

Looking at the figures alone, the picture is a mixed one of trusts and foundations that have seen reductions in asset values since Autumn 2008 and some whose assets have retained their value, some who have seen a decrease in income and others whose income has increased.

If we look at the data on grant-making, it appears that a vast majority of these trusts and foundations are intending to keep grant-making steady, while others expect some reduction or an increase. Underlying this mixed picture is a more complex story that the tables above, and any figures, conceal.

5.2.1 Sources of income

Endowed trusts and foundations

The majority of trusts and foundations interviewed were endowed and obtained income from investment return on their assets. Their primary activity was grant-making. However, as discussed further below, the majority of these trusts and foundations operated a Total Return approach to spending creating a more complex relationship between assets, income and spending.

Corporate trusts and foundations

The corporate trusts and foundations were in a somewhat different position insofar as they depended for income on an annual allocation from their corporate funder. In one case, income had remained steady since Autumn 2008 despite difficulties in the corporate funder's position; in another case, income had increased due to the corporate funder's takeover of another company and a desire to increase its giving in line with an expansion in its areas of business and its higher profile.

Fundraising trusts and foundations

Both of the broadcast appeal foundations interviewed had experienced no reduction in fundraised income since Autumn 2008, and one had seen an increase. The community foundation included in the study

The real effects of the downturn on these trusts' and foundations' assets, income and future grant-making have to be seen in the context of:

- Sources of income for grant-making and operating
- Board approaches and previous planning
- Life expectancy (formal and informal)
- Investment policies
- The balance between the needs of current and future beneficiaries
- Other commitments

reported that its fundraised income was "holding up better than we ever dared to hope; there have been some losses of corporate donors but those have been compensated for by other gains".

The problem for the fundraising trusts and foundations was that they depend on income from investments to cover operating costs and this income has been significantly reduced. For Comic Relief and BBC Children in Need the major constraint was their pledge to the public that every penny raised from the public goes to those in need.

Big Lottery Fund was also suffering from the effects of reduced income from (short-term) investments to cover operating costs, but this was largely offset by an increase in Lottery ticket sales.

Living donors

In addition to the community foundation and, in a different sense, the corporate trusts and foundations, one group of trusts and foundations included in the study had living individual/family donors. Whereas the community foundation reported some losses and gains from living donors, in this group of trusts and foundations, donors have "always calibrated additional giving according to the scale of grant-making they wanted to do at any time, so the downturn is just an additional consideration in that".

5.2.2 Steady Boards and previous planning

Steady Boards

All the trusts and foundations interviewed had spent considerable time in Board meetings and other committees discussing the effects and implications of the downturn. Phrases such as “an inordinate amount of time” and “countless hours” were frequently used.

Boards’ overall approaches varied in detail but the general view was that “now is not the time to do anything radical; this isn’t a time to panic”, and “we are debating and discussing, taking what steps we can, informing ourselves and making provisional decisions – waiting to see where the pinch points will be”. “Holding our nerve” was another frequently used phrase.

Some trusts and foundations suggested that they had experienced worse shocks before: Advanced Corporation Tax (ACT) changes had hit some trusts and foundations very hard, as had the dot.com crash and previous investment losses. The older and permanently endowed trusts and foundations emphasised that they are experienced in managing shocks, and have invested fairly cautiously for the long term.

Previous planning

Previous planning was also an important factor in the ways in which trusts and foundations were responding to the current downturn. Several foundations had engaged in major planning exercises and reviews in recent years (sometimes prompted by a change of Chief Executive Officer or by previous downturns in income) and, in the process, had clarified some key issues and principles on which they were now drawing, and were keen to follow through.

Reviews had clarified the trust/foundation’s areas of interest, its notions of ‘good grant-making’ and its style of operating. These decisions were an important factor in considering any changes to areas of grant-making, size of grants and ways of working.

Reducing operating costs is obviously one way in which trusts and foundations might attempt to release income for grant-making; but reducing operating costs may also have important indirect effects on the quality of grant-making and the type of support offered to grantees.

A number of trusts and foundations had in recent years reviewed operating costs and staffing and some had made significant cuts at a time of previous reductions in income, or a time of take over or merger (eg of a parent/related company) or as part of a wider review related to purpose and activities.

Staffing matters

One trust/foundation described itself as “trying to cut costs anyway, unrelated to the downturn”, and another was “looking hard at efficiencies and at projects that are not time critical and can be postponed”. Another was aiming to cut £100,000 on staffing and running costs primarily by taking on more work with the same number of staff: “We won’t be as involved as before but we think it’s manageable”.

More generally, however, interviewees described their organisations as not only looking carefully at reducing costs but, equally important, looking at ways of allocating spending for maximum effectiveness which might actually include spending more, not less, on operating costs – e.g. allocating additional staff time to working with grant recipients or on other activities to increase sustainability of projects. One person said: “Yes, of course, we could cut operating costs but it wouldn’t make us more effective. It would turn us into a very different sort of grant-maker and not the sort trustees want to return to.”

Only one trust/foundation had, so far, made any cuts in staffing. Elsewhere, cuts in staffing had been made as part of previous reviews and no further reductions were anticipated.

Staff pay was generally related to the Retail Price Index (RPI) so there had been only ‘modest’ increases which one person suggested was “effectively a pay cut”. Some trusts and foundations operated with two- or three-year agreements and were at a stage when they had not had to consider this issue. For the spending out trusts and foundations there was an additional consideration: “We’ve got the money and because we have a limited life we need to work to keep good staff – so why would we penalise them?”

5.2.3 Life expectancy

The spend out trusts and foundations had been largely unaffected in terms of asset values largely because of their short-term, very cautious, investment policies and their high levels of liquidity. However, this did not necessarily mean that the same amounts were being spent on grant-making. For these trusts and foundations (as for some others) spend on

grant-making depended on the stage a particular programme had reached, and on the strategy the trust/foundation was adopting in its final years. In one case this meant that less was being spent on grants this year – but this was unrelated to the downturn.

5.2.4 Investment policies

The wide range of different investment strategies is highlighted by the trusts and foundations interviewed. The approaches they took to investment played a critical role in their responses to the downturn in at least two related ways: use of a Total Return approach, and patterns of investment

investment management where this option was available and applicable. This allows trustees to manage investments without the need to take into account whether the return is income, dividends, interest, or capital gains and losses. Normally a Total Return approach cannot be adopted in relation to permanent endowment funds although the Charity Commission can permit this for charities in England and Wales.

A Total Return approach

The majority of the endowed trusts and foundations interviewed adopted a Total Return approach to

Table 5.2.4 Use of a Total Return approach

Total Return Approach (TRA)	Used	Not used	TRA not available or applicable
Number of trusts and foundations	9	1	9

With one possible exception, trusts and foundations adopting a Total Return approach found this very helpful in responding to the downturn. As one person summed it up: “Total Return works to avoid over-reaction in good and bad times”.

The effects of the downturn on asset values, income and grant-making need to be seen in the context of the ‘good times’ as much as the ‘bad times’. The downturn after a period of significant growth has had two effects. One was that some trusts and foundations saw their asset values as returning to a pre-growth value, the value in the growth period having been viewed by some as over-inflated and unsustainable. The other effect was that in the last

few years, as a result of significant growth, some trusts and foundations had decided to begin to spend some of that growth which was then added to the grant-making ‘pot’ creating an increase or a steady state in grant-making despite reduction in income: “We have some slack because we didn’t go wild in the good years, because we saw that returns were way in excess of what they should have been. Our investment policy is based on a 6% real return policy plus inflation (a total of about 8%); spending at 4.5% leaving a margin to deal with inflation and to increase the portfolio over time. This can sometimes favour future generations, so occasionally the trustees agree a special dividend to be spent on grant-making”.

Adapting investment policies

Permanently endowed trusts and foundations emphasised that they took a long-term view of investments. This was not the case for the trusts and foundations that were spending out, nor for the two broadcast appeal foundations dependent on their investments to cover operating costs rather than to fund programmes.

The spending out trusts and foundations and the broadcast appeal foundations were more concerned with securing their income in the short term and thus adapted their investment policies accordingly, emphasising safety over return and the importance of liquidity. For the broadcast appeal foundations, liquidity was also important because of their grant-making cycles and numbers of grants given.

Wider investment approaches

Ethical investment policies were not widely adopted. The most likely approach was simply to ban one or two types of investments (such as tobacco-related investments). Lack of an ethical investment policy was usually explained in terms of trustee opposition on the grounds of a responsibility to achieve maximum return. One foundation that did have a highly developed ethical investment policy felt that it may have suffered, not so much because of its ethical base but rather because of its exposure to small and medium sized companies; it was now considering greater engagement with larger companies.

Mission-related investment approaches (MRI) - used here loosely to refer to investments designed to further a charitable objective - were more common than ethical investment policies, but if adopted generally reserved for a small part of the portfolio. One foundation suggested that these types of investment had typically performed rather better than some other 'market' investments, giving "at least a return of investment if not a return on investment. It's making us re-think just what a 'market return' really means".

Foreign exchange

Exposure to foreign currency exchanges worked to the benefit of those trusts and foundations that had invested heavily in the Euro and the US Dollar.

Other trusts and foundations with globally diversified portfolios had also benefited in various ways. As discussed below, however, exposure to foreign currency fluctuations was a problem for trusts and foundations engaged in international grant-making.

One foundation had hedged ('insured') its foreign exchange exposure - at considerable cost - and two others were considering this. Some argued, however, that although this was tempting, it was probably too late to be helpful. One trustee suggested that in all the speculation about what may or may not happen "our job isn't to take a view but to hedge".

Changes to investment policies

Some trusts and foundations 'had seen the writing on the wall' (partly as a result of tracking asset values over decades as part of a Total Return approach) and changed their investment strategies.

Several trusts and foundations had started selling those assets which they deemed to be higher risk early on. Others had moved these assets out of banks to cash and gilts. In some cases these moves were not wholly in line with the advice of their investment managers. Interestingly, one foundation employs an independent consultant to explain to the Board the advice of investment managers. "The higher the rate, the higher the risk is an old adage but still true" seemed to be the view of a number of interviewees.

The spending out foundations had already made these moves and therefore lost very little if anything. Others now reported "record levels of liquidity" and some were now planning to re-enter the market to "invest in some bargains". In some cases, levels of liquidity had important effects on their ability to maintain levels of grant-making (see below).

One foundation said that its philosophy was that three things destroy a foundation: a single asset; a liquidity squeeze leading to the sale of good assets at distressed prices; and inflation (requiring investment that can withstand even high levels of inflation).

5.2.5 Balancing the needs of current and future beneficiaries

Approaches to grant-making in the downturn were related to views on the balance to be maintained between serving the needs of current and future beneficiaries. Non-endowed trusts and foundations were more likely to focus on the needs of current beneficiaries. Permanently endowed trusts and foundations were all conscious of a responsibility to future beneficiaries – but how this was interpreted in practice varied.

Funding counter-cyclically?

None of the trustees and foundations interviewed were explicitly committed to funding counter-cyclically although several expressed a view that it was their client group/causes that “would get hammered” and that this was an “appropriate time” to maintain funding even at the cost of reducing the asset base. One foundation suggested: “Funding counter-cyclically is implicitly reflected in drawing down the reserves”. Whilst there wasn’t clear evidence of commitment to counter-cyclical funding at present, a clear desire was expressed on the part of trusts and foundations to seek to protect the charities they fund from any drop in income they may be experiencing themselves.

One trust/foundation said that it was maintaining grants at previous levels, even though this would mean dipping into capital in order to “maintain faith and trust with grantees” with whom they had a long-standing relationship; another said that it would be wrong to reduce spending in the face of increased need. Others took the view that reducing capital would be a breach of trust. Several foundations distinguished between a responsibility to preserve the endowment and attempting to increase the endowment: “there’s nothing charitable about working to increase the endowment”.

Spending beyond current return

There were variations in degrees of risk aversion to dipping into capital (which is different from spending the income gains from capital). Some do so readily, some want to go more gently, some are very confident that capital will recover relatively quickly. For those with an expendable endowment, reducing the asset value was obviously an easier position take

than for those with a permanent endowment, since permission would be required from the Commission to spend permanent endowment.

Willingness to spend beyond current return was also related to forward grant commitments and to availability of cash. Availability of cash meant “spending the endowment, but not distressed assets, makes trustees more willing to spend”. There was also a view that “if cash is earning very little you might as well spend it”. For those without cash to spend, there were also more practical considerations to do with selling at the bottom of the market and further reducing income.

One foundation originally took £50 million in cash to buy at the bottom of the market but feeling unsure about investing at the present time had decided to use some of this money for grant-making instead.

In general, for endowed trusts and foundations, spending beyond returns was not, at present, regarded as a major issue, but most noted that this view would change if it continued over several years. Most endowed trusts and foundations have a required or chosen value below which they will not allow their capital to drop.

If the downturn continues or deepens, some trusts and foundations would have to reduce expenditure in order to preserve the value of their capital.

The problem for fundraising foundations

As noted above, for two of the fundraising trusts and foundations, the key issue was not about perpetuity or balancing the needs of current and future beneficiaries but rather how to cover operating costs from diminished interest income. Both of the broadcast appeal foundations were able to continue previous levels of grant-making and cover operating costs by drawing on their relatively small reserves – but this was not sustainable for more than a couple of years. Both were exploring ways in which they might deal with a long-term problem.

5.2.6 Other commitments

In some cases, figures on changes in income and grant-making were the result of factors unrelated to the downturn. For example, Big Lottery Fund's grant-making budget had been reduced due to their contribution to the Olympics; City Bridge Trust has to budget in the coming years for forthcoming bridge

maintenance; two trusts and foundations had significantly increased their grant-making totals last year with a very large grant (included in the figures for one year but to be paid over three years) creating an apparent drop in grant-making this year.

5.3 Projected effects of trusts' and foundations' strategies on the voluntary sector

As noted above, the trusts and foundations interviewed were generally hoping to maintain grant-making at previous levels. Northern Rock Foundation was the only trust/foundation interviewed that had cut the number of its programmes (following nationalisation of the Bank and settlement of a revised funding position).

So how did the trusts and foundations interviewed view the effect of their strategies on the voluntary sector?

These large trusts and foundations did not see the effects of their strategies on the voluntary sector as being, in general, significant. They recognised that their contribution to **total** charity sector income was relatively small, and that they could not hope to make a significant difference in more than a few areas of activity. Trusts and foundations were, however, concerned about their particular causes/client groups and were committed to mitigating what they saw as the likely effects of the downturn on those – even if they recognised that trusts and foundations were only small players in a bigger drama.

Supporting failing organisations?

Trusts and foundations did not generally see their role as supporting failing organisations. Indeed, a number of trusts and foundations questioned whether it would always be desirable to 'save' failing organisations, and saw some potential beneficial effects in encouraging greater collaboration, "sorting out the sector" and "getting rid of the froth, the wish lists, rather than the core". But if a trust/foundation had a close relationship to an organisation central to delivery of desired outcomes then it might consider "tiding over".

Special programmes?

Several trusts and foundations had considered creating special programmes for the downturn, but had rejected the idea on the grounds that their existing programmes gave them sufficient flexibility to respond to needs. There was little enthusiasm for the notion of an emergency support fund for ailing organisations. As noted elsewhere these trusts and foundations were more inclined to consider such support case by case.

Core funding

Some trusts and foundations were considering the balance between core and project funding, and those who had tended toward project funding expected to be more 'flexible' on supporting core costs. As yet, it was not clear exactly what this would mean, and foundations were aware of the dilemmas associated with becoming too involved in on-going, core funding.

Smaller grants and spending to succeed

Trusts and foundations interviewed were not generally considering making smaller grants. Indeed, some talked about "spending more to succeed"; there was a reluctance to "go back to the bad old days of funding for failure".

'Spending to succeed' was also raised in relation to sustainability. "There is this belief that if we demonstrate, then others will pick up. We may need to re-think that" (ie if there are no others likely to pick up). "If we say we are driven by outcomes we will need to be smarter about helping organisations to get to sustainability."

International grant-making

The effects of foreign currency exchange rates had implications for those engaged in international grant-making. Ways of dealing with this varied from making grants up to the level previously agreed, to asking grantees to do what they can with the resources now available. In part this choice depended on the number and value of grants affected, relative to the foundation's ability to bear the loss.

Greater scrutiny?

Trusts and foundations were considering engaging in greater scrutiny of organisations' financial viability: "being more vigilant about the financial viability of the organisation and the proposed project". These trusts and foundations were spending more time looking at organisations' accounts, assessing their likely sustainability. Some were also considering making grants in smaller more regular instalments to protect the trust/foundation as an unsecured creditor.

Table 5.3 *Effects of the downturn on approaches to risk in grant-making*

Effects on Risk	More cautious	Less cautious	No change
Number of trusts and foundations	16	0	3

Approaches to risk

More generally, did trusts and foundations see themselves as becoming more risk averse in their grant-making?

The main effect on approaches to risk was that noted above concerning greater scrutiny of financial viability of applicants. More generally, trusts and foundations described themselves as "being a bit more cautious", "bold but not quite so bold". At the same time, however, there was a concern to avoid any tendency to reduce the sector's capacity for innovation. "I worry a bit that if we try to support organisations by relaxing the innovation requirement, we'll start chipping away at innovation".

For some trusts and foundations, another concern was that local authority budget cuts, and losses of corporate giving, would have implications for use of their own grants where these depended on availability of such resources. "We'll need to get smarter about who is doing what, and who isn't doing what – old assumptions that x does that won't necessarily hold."

It is also worth noting that trusts and foundations were not in general inundated with applications (as some had expected). There was, however, a view that if the downturn continues then demand would increase.

5.4 Does the downturn have a silver lining?

The trusts and foundations interviewed suggested a range of potential benefits to the downturn. These were:

- **Deeper thinking and greater vigilance**

“Deeper thinking regarding the right investment policy”; “greater involvement, understanding and questioning of investment policies by all members of the Board”; “being even more vigilant”; “bringing together the collective minds of Committee members”; “being more rigorous – but not getting too rigorous”.

- **More collaboration**

“This has prompted, or may prompt, more collaboration and risk sharing”; “wanting to fill the gaps left by other funders could be a positive spur to working in a more complementary, co-ordinated way”; “we might begin to question competitive tendering and focus more on getting people around a table and playing to their strengths”. Some trusts and foundations were already co-funding (ie each funding a part of) a programme of work, or pooling funding to create a larger pot for a larger or wider programme; and some hoped that others would be encouraged to consider such arrangements.

- **Spending out**

“Maybe there will be greater debate around the advantages and disadvantages of spending out”; “Some trustees now see a stronger case for spending out. If capital values can be eroded so quickly, then it may be better to spend than to lose in the market. And we are moving into a period of greater need, so why not make more of an impact sooner and have the added advantage of seeing the benefits of that in your own lifetime.”

- **Questioning of values**

“We need to realise that we have all been complicit in the boom, highlighting the need to question what is this ‘good’ we do and having a debate on using all our resources for good.”

“There’s an increasing awareness that greed got us into this and I see a questioning of values, more thinking about social conscience, collegiality, making do with less, focusing on the essentials.”

For some trusts and foundations, this questioning of values related to broad social issues – the ‘good society’ – and to approaches to investment.

- **Reshaping the sector**

“Perhaps we’ll get back to where the voluntary sector was before it got bogged down in contracting – that would be a really good effect even though there would be some pain along the way.” “It’s an interesting moment – for reshaping the sector, creativity coming out of crisis, and so on.” “Selective rescue might not be a bad thing – there are things worth rescuing and some that are not.” For some, ‘reshaping the sector’ was partly about greater emphasis on local community building and volunteering; others pointed to the way in which the sector has grown and sometimes duplicated in recent years.

- **Corporate involvement**

“Despite the fall in corporate giving, this might be a time when businesses might look to charitable endeavour as a way of galvanising staff morale and team building.”

“Charitable appeals could gain profile and recognition from the downturn if businesses and other organisations appreciate the need to demonstrate their wider social concern and responsibility.”

- **Investment opportunities**

“This is a good opportunity for investment – purchasing property and so on.” “One of the good effects for us has been that it has reduced the likelihood of overspend on capital projects and made it easier to negotiate with contractors.”

5.5 Projected effects on grant-making beyond 2010

An uncertain picture

Despite these potentially beneficial effects, trusts and foundations were keen to stress that the damaging effects of the downturn are still uncertain. Looking forward to likely effects on grant-making beyond

2010, trusts and foundations saw a potentially different picture. For those operating a Total Return approach based on a three year (twelve quarter) trailing average, the impact on income had yet to take full effect.

Table 5.5 Projected effects on grant-making beyond 2010

Effects beyond 2010	Increase	Decrease	No change (constant)	Uncertain
Number of trusts and foundations	0	1	8	10

One factor in trusts and foundations' projections beyond 2010 was obviously their optimism or pessimism regarding the length of the downturn. The majority stressed that their capacity to continue dipping into capital was limited. Some had aimed to have enough liquidity to weather a storm of several years – but “will the trustees nerve hold that long?” Some proposed a “hand on the tiller now to avoid deeper cuts later”.

While there was some optimism that the worst was over, a minority questioned whether this downturn is different: “Is this a paradigm shift? When do we decide? What indicators would help us decide?”

The longer-term effects on public spending

Irrespective of their optimism – or pessimism – about their own future resources, trusts' and foundations' greatest anxieties were about the longer-term effects on public spending, and the implications both for wider society and for the likely demands on them. One trust/foundation asked: “Will this be death by a thousand cuts with organisations not going under but just about keeping going, providing less and less adequate services in more and more tacky conditions?”

5.6 What might be done?

As part of this research, we took the opportunity to ask the trusts and foundations interviewed whether or not there was anything the Commission as regulator, or the Office of the Third Sector (OTS), or HM Revenue and Customs (HMRC) and the Government generally, could do to support the sector and help it cope more easily with the impact of the downturn. A wide range of suggestions, issues and questions was raised.

The issues included specific points relating to income and expenditure, for example, on maintaining an appropriate balance between past and present commitments; the need for clarity on what is or isn't expendable; and a need to think through different

approaches to Total Return and how these can be presented in SORP.

There was an appetite for further debate on issues relating to sustainable, ethical and mission-related investments and for discussion on when spending out should be considered as an option. Interest was expressed in how the voice of small and medium size charities can be better promoted and supported, and concerns were expressed about the impact of public funding cuts on the charitable sector.

The Charity Commission plans to hold a joint seminar with the Association of Charitable Foundations in Autumn 2009 to explore these issues in more depth.

Annex A – Sample and methodology

A number of depth interviews were carried out with a range of trusts and foundations. The tables below provide details of sample composition as regards

source of income, size of asset base, and size of spending.

Table A1 *Profile of trusts and foundations interviewed by source of income*

Source of income	Endowed	Fundraising	Corporate
Number of trusts and foundations	13	4*	2

* Includes Big Lottery Fund

Two trusts and foundations were formally spending down, and at least two others were considering this.

Table A2 *Profile of trusts and foundations interviewed by size of asset base*

Size of asset base	Number of trusts & foundations
Over £1 billion	3
£501 million – £1 billion	2
£101 million – £500 million	5
£50 million – £100 million	0
Under £50 million	4
No asset base	4

Table A3 *Profile of trusts and foundations interviewed by size of spending*

Size of spending	Number of trusts & foundations
Over £100 million	2
£81 million – £100million	1
£61 million – £80 million	1
£41 million – £60 million	0
£21 million – £40 million	4
£10 million – £20 million	5
Under £10 million	6

Annex B – Existing data and experience from previous downturns

The Association of Charitable Foundations (ACF) carried out a survey of its members in April and May 2009 to assess the impact of the current downturn on trusts and foundations. Questionnaires were sent to Chief Executives of all ACF members and 95 responses were received; a response rate of 33%.

ACF reported that the main findings from the survey suggest that UK-based trusts and foundations are weathering the downturn better than many other sectors, with nearly 75% predicting steady or rising income levels over the longer term and two-thirds planning to maintain or increase their level of grant-making. This optimistic outlook was despite experiencing short-term falls in the value of their investments.

Over 75% of respondents reported having reviewed their investment strategy as a result of the credit crunch, with a significant number commenting that they would continue their current strategy but keep it under review.

For this year, 36% of ACF members expect to maintain current levels of grant-making, with 9% increasing these levels. Looking forward, 15% anticipate higher grant-making in 2010, and 38% plan to increase grant-making over the longer term.

What some respondents do expect are changes in the nature of the grants they make next year: 44% are likely to give fewer grants; 27% believe their grants will be smaller, and 23% think they will be given over shorter periods.

Trust and foundation assets have been hit by the downturn, but the picture is more promising than in many other sectors. While 75% of respondents reported a significant decrease in investment value over the past 12 months, 40% said that share dividend income had remained steady. Only 12% foresee a continuing decrease in income over the longer term.

The limited data from previous downturns illustrate the disjunction between effects on trusts' and foundations' income and assets and patterns of giving. US Foundation Center data suggest that in the downturns of the 1980's and 1990's:

- US foundation giving did **not** decline (in inflation-adjusted dollars)
- US foundation giving priorities remained relatively stable.
- Many US foundations sought to be counter-cyclical – ie spending to offset the effects of downturn.

Annex C – Glossary of terms

Advanced Corporation Tax (ACT): ACT was the scheme under which companies made an advance payment of tax when they distributed dividend payments to shareholders. The principle was similar to the way that interest earned on bank deposits in the UK normally has basic rate tax deducted by the bank before being paid to the account holder. In general this payment meant that the recipient of the dividend was considered to have already paid basic rate tax on their dividend income. Certain recipients, including charities and pension funds, who would not otherwise have paid income tax on the dividend income were entitled to claim back this (or later a lesser) amount from the Treasury. ACT was scrapped with effect from 6 April 1999.

Beneficiaries: The individuals and groups or organisations that benefit or who could potentially benefit from the support given by a charity, including trusts and foundations.

Capital: The principal or capital sum of an estate or trust, as opposed to interest or income.

Core funding: Funding to cover or partially cover the overhead costs of an organisation, as opposed to those specific to a project. Whilst these costs do not directly produce outputs of charitable activity, they are necessary to deliver these activities. Examples include general management staff, IT equipment and training, fundraising and governance.

Counter cyclical: A financial policy is called counter cyclical if it works against the cyclical tendencies in the economy.

Ethical investment: The practice of investing in an enterprise which does not morally or ethically offend the investor or of which the investor approves on ethical grounds – also called socially responsible investment.

Endowment: Assets, funds, or property bequeathed, settled upon or donated to an institution, individual, or group as a source of income:

- **Expendable endowment:** Depending on the conditions attached to the endowment, the trustees will have a legal power to convert all or part of it into an income fund which can then be spent. However, there is no actual requirement to spend the principal of the endowment for the purposes of the charity unless or until the trustees decide to. Income generated from an expendable endowment is no different from income generated from permanent endowment, and should be spent for the purposes of the charity within a reasonable time of receipt.
- **Permanent endowment:** Property of a charity (including land, buildings, cash or investments) which the trustees may not spend as if it were income, unless they have obtained permission from the Charity Commission. It must be held permanently, sometimes to be used in furthering the charity's purposes, sometimes to produce an income for the charity. The terms of the endowment may permit assets within the fund to be sold and reinvested, or may provide that some or all of the assets are retained indefinitely (for example, a particular building).

Gift Aid: A way for charities or community amateur sports clubs (CASCs) to increase the value of monetary gifts from UK taxpayers by claiming back the basic rate tax paid by

Gilts: Risk-free bonds issued by the British government.

Hedge: A tool used to protect against the risks posed by worldwide currency fluctuations. If fund managers think the dollar is going to be stronger when they are ready to change the foreign currency back into US dollars, then they take out a foreign futures contract (a hedge). Thus, they lock in the exchange rate beforehand, so that they will not lose profits gained from holding devalued foreign currency. If the manager thinks the dollar will weaken against foreign currencies, there's no real reason to hedge. In fact, if the manager guesses correctly, he or she will boost the fund's overall return because the profits will be worth even more when they are exchanged into US dollars.

Liquidity: The extent or ease to/with which an organisation can convert its assets into cash.

Mission-related investment: The practice of aligning trust/foundation asset investment with its charitable or philanthropic mission. It enhances the charitable or philanthropic pursuit by considering whether and how the externalities generated by a foundation's asset investment strategy may counter its mission, and by judiciously harnessing the power of investment assets to drive positive social and environmental benefits.

Reserves: The term 'reserves' has a variety of technical and ordinary meanings, depending on the context in which it is used. In the Charities SORP 2005 (Accounting and Reporting by Charities: Statement of Recommended Practice), the term 'reserves' is used to describe that part of a charity's income funds that is freely available. In that context, 'reserves' are the resources the charity has or can make available to spend for any or all of the charity's purposes once it has met its commitments and covered its other planned expenditure.

Retail Price Index (RPI): An important domestic indicator of inflation in the United Kingdom (UK). It measures the average change from month to month in the prices of goods and services purchased in the UK.

Risk capital: Funds invested or available for investment in a new or unproven enterprise.

Social enterprise: A business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners.

Social investment bank: The Government in its April 2009 budget outlined its intention to consult on the design and function of a social investment wholesale bank in order to support the long-term growth of a thriving third sector. The intention is that the Office of the Third Sector will report back with substantive proposals.

SORP: The Statement of Recommended Practice (commonly referred to as SORP) is issued by the Charity Commission and the Office of the Scottish Regulator (OSCR). It provides instructions as to how charities are expected to report their activities, income, and expenditure, and financial position in their annual report and accounts.

Spending out: The situation where a time-limited foundation is spending all or part of its capital assets in furtherance of its charitable objectives.

Sustainability: Returning and recycling capital, with the potential for broader and more lasting impact.

Total Return approach: An approach which allows flexibility in managing invested permanent endowment where the trustee considers the overall return made, whether from income or capital gains or losses, and decides how much of that return to allocate to fund expenditure for that year. A Total Return approach creates a lag in the effects of reductions in value of assets and income.

Trusts and foundations: The terms 'trust' and 'foundation' are often used interchangeably. All charitable foundations are trusts – that is, they are managed by trustees who may or may not be supported by paid staff. Foundations do not, therefore, have a distinct legal identity or constitution and are subject to the same public benefit tests, governance and accounting requirements, and Charity Commission regulation as all other charities. They derive their income from an endowment of land or invested capital. Not all foundations make grants; some use their income to finance charitable activity of their own. This means that the difference between the terms 'foundation', 'trust' and 'charity' in the UK is semantic only; charities whose principal activity is grant-making are usually called 'charitable trusts' or 'charitable foundations', in preference to 'charities'.

- **Charitable trust:** A trust is an arrangement whereby a person or persons (the trustees) is (are) made the nominal owner of property for the benefit of another person or group of people (the beneficiaries). Where the trust is charitable, the beneficiaries are not named and the purposes are public. The trust deed will specify either a wide group of people, any of whom can benefit, or a charitable purpose.
- **Community foundation:** A grant-making charity established to strengthen local communities, create opportunities and tackle issues of disadvantage and exclusion.
- **Corporate trust/foundation:** A trust or foundation set up by a commercial business to carry out charitable activities.

Annex D – Signposting to resources

The Charity Commission for England & Wales

The Charity Commission is the independent regulator of charities in England and Wales. Its aim is to provide the best possible regulation of charities in England and Wales in order to increase charities' effectiveness and public confidence and trust. Most charities must register with the Commission, although some special types of charity do not have to register. There are some 190,000 registered charities in England and Wales. In Scotland the framework is different, and the Commission does not regulate Scottish charities.

The Commission provides a wide range of advice and guidance to charities and their trustees, and can often help with problems. Registered charities with an annual income over a certain threshold must provide annual information and accounts to the Commission. The Commission has wide powers to intervene in the affairs of a charity where things have gone wrong.

More information about the Commission, together with a range of guidance for charities, can be found on our website: www.charitycommission.gov.uk, or by contacting Charity Commission Direct:

Telephone: 0845 300 0218

Minicom: 0845 300 0219

By post: Charity Commission Direct
PO Box 1227
L69 3UG

Relevant Charity Commission publications

Readers may find the following Charity Commission publications helpful – available on our website – and relevant to some of the issues raised in this report:

The Big Board Talk: The economic downturn – 15 questions trustees need to ask

Permanent Endowment (OG44)

Investment of Charitable Funds: Basic Principles (CC14 – currently being revised)

Endowed Charities: A Total Return approach to investment (OG83)

Charities & Social Investment

Charity Income Reserves (OG43)

Charity Reserves (CC19)

Charities & Risk Management (on-line guidance only)

Guide to Corporate Foundations

SORP

Association of Charitable Foundations (ACF)

ACF promotes and support the work of charitable grant-making trusts and foundations. Their contact details are:

Central House, 14 Upper Woburn Place,
London WC1H 0AE

Tel: 020 7255 4499

Email: acf@acf.org.uk

Website: www.acf.org.uk

Notes

This publication can also be accessed at the Charity Commission's website: www.charitycommission.gov.uk

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