Beyond The Sunset: How to not Burden the Next Generation Once Things have Gone Dark

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INTRODUCTION

"Far and away the best prize that life has to offer is the chance to work hard at the work worth doing." - ***Theodore Roosevelt***

Photo Credit: Cole Kitchen

There is growing discourse that charitable foundations should not be held in perpetuity; that the needs of today's society outweigh the benefits of holding onto charitable assets for generations. Sunsetting, or spending down a foundation, requires more than just legal considerations. Like any company, sunsetting a foundation has both an emotional as well as an economic toll. To help you get full grasp of this, here are six questions to consider before shutting down your charitable giving vehicle, be it is a private foundation or a donor advised fund (DAF).

Questions to Ask When Sunsetting a Foundation Or DAF

1. Would you have more impact by spending down your foundation or by maintaining it for generations to come?

2. What role do you see the next generation playing in a sunsetting scenario and in a legacy scenario?

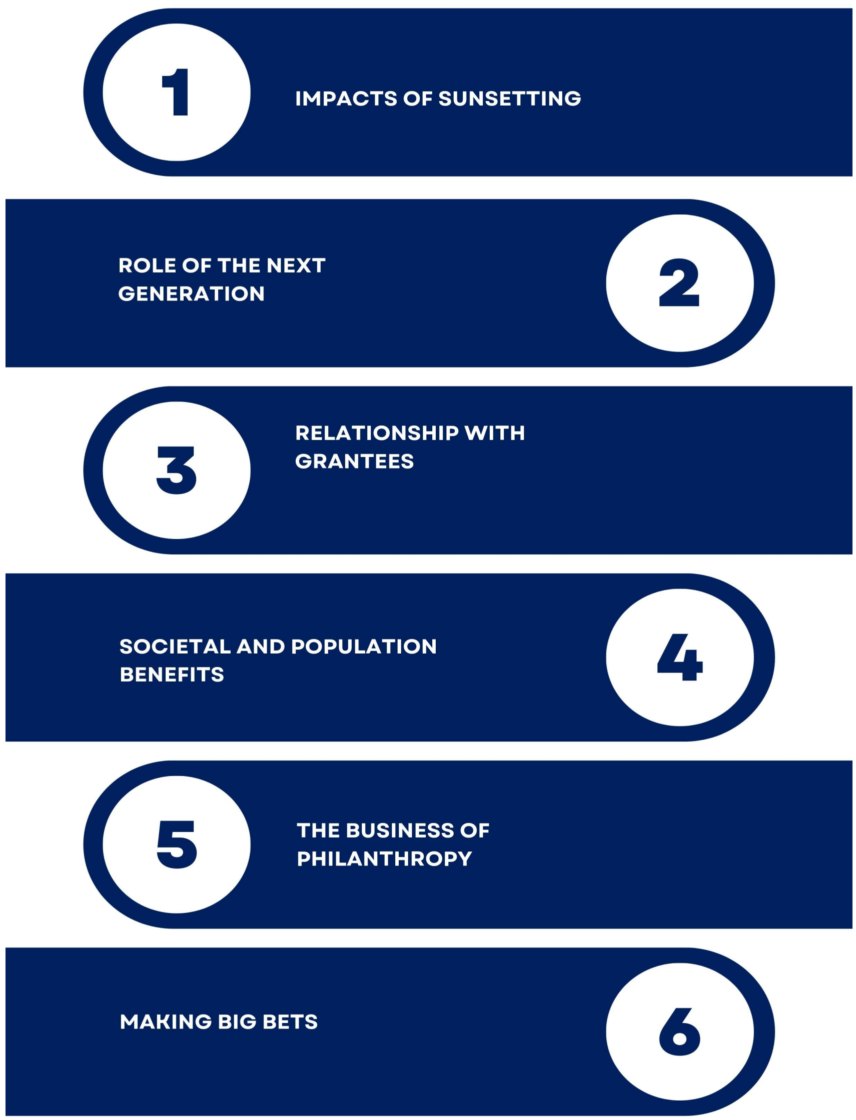
3. What financial plans do you have, both from your own wealth planning (taxes) perspective and those of the grantees that you support? This is particularly important for those you provide with multi-year or “Big Bet” grants.

4. How does society benefit from holding on to these assets past your lifetime?

5. What are the costs (familial and operating) associated with maintaining a foundation in perpetuity?

6. How narrow is too narrow and how broad is too broad when you decide to spend down?

In the course of this paper, we addressed these six questions in the following ways:



EXECUTIVE SUMMARY

The question of whether to sunset (close down) a charitable foundation is complex, with many factors to weigh. This white paper examines the key considerations around sunsetting, including the potential benefits and drawbacks for impact, family engagement, grantees, and society.

While sunsetting can allow for greater immediate impact through rapid spend-down of assets, it reduces the long-term capital and support available to grantees. Multi-year grants and clear timelines help grantees financially plan for a foundation's closure.

Perpetual foundations are designed, in part, to transmit family values and history. The act of spending down these charitable giving structures creates space for the remaining family members to explore a personalized social vision. Engaging inheritors early enables a smooth transition of board leadership as well as allows for deeper conversations about family values and legacy.

Big Bet "moonshot" philanthropy requires reliable assets to fund high-risk, high-reward ideas. Yet sunsetting limits the ability to make such Big Bets in the long run. Perpetual foundations incur heavy operating costs over time, but they also allow the family to continue making Big Bets.

Ultimately the decision depends on alignment with family values, risk tolerance, and charitable vision. Some alternatives beyond all-or-nothing sunsetting exist too. With care and communication, sunsetting can be executed successfully. This paper offers guidance on key considerations for foundations weighing these options.

WEIGHING IMPACT: THE BENEFITS AND TRADEOFFS OF SUNSETTING

Philanthropic impact can be measured in three ways: at the individual level, at the capacity level of an organization and at the societal or sector level creating shifts in the issue area.

When you consider sunsetting, the type of impact you want to have may evolve from where you are currently fostering change to another type of social shift. The impact you generate is, in part, influenced by the size of donation, the commitment to the organization, the way your contribution is being leveraged and the type of program or agency you are supporting. Be clear on what is important to you. The role that your philanthropy plays in generating social impact and your own perception of risk (donor risk tolerance) is a key factor in determining when and how to wind down your charitable giving.

Curious what your Donor Risk Tolerance is?

Take our quiz to determine your Donor Type.

When exploring the questions of impact and shutting down your grant-making, consider the different time horizons of the stakeholders (you, your family and the grantees). Once you have a sense of those varying timelines, you can determine the best way to wean grantees off of your funding and provide a road map for the next generation who may be responsible for completing the spend-down when you are gone.

Ultimately, the sunsetting conversation between foundation and grantee leadership can lead to heightened relationships and a deeper understanding of the issues that the Founder is looking to address.

Photo Credit: RDNE Stock Project

ENGAGING THE NEXT GENERATION FOR A SMOOTH TRANSITION

The current size of your foundation + investment performance - the ongoing and future commitments = the total funds you will need to deploy in the spend-down process.

Foundations that were originally established as legacy foundations (i.e. one that was not originally intended to sunset) may require a review and revision to governing documents:

- Terms, roles and responsibilities of Board Members
- Funding and investment policies
- Grant-making and disbursement policies

For a complete list of the documentation that families may want, please see this Family Capital Chart.

Once you have looked over your governing documents and have made the necessary changes, you can plan the financial spend-down. Examples of a spend-down are:

- **Foundation asset management.** Rapid ramping up of funding to outpace the investment growth, a leveling out period, then a controlled spend-down. Depending on the original base and the original disbursement levels, this may be done within the lifetime of the Founder.

- **Design the spend-down at the point of inception of the foundation**. The financial forecasting and disbursement calendar should be set up as early as possible so that any adjustments can be made and the "surprises" of market fluctuations will not be so drastic that multi-year commitments cannot be met, or that sunsetting timelines are not extended beyond what the Founder feels is reasonable.

- **Making a Big Bet (or series of Moonshots).** Deploying large amounts of capital over a specific period of time (typically between 3-5yrs) to higher risk ideas, start-up organizations or scaling solutions.

As part of this planning process, you set the stage to engage the Next Generation/Inheritors. Ultimately, you want the transition to be as smooth as possible, which requires having a sense of the time horizons of all parties involved. By providing an engagement timeline, you allow the Next Generation to plan their own involvement and commitment level to the foundation and to supporting your legacy.

In a sunsetting model, the role of the Next Generation is to support the plan in several ways: in its creation and execution, and most certainly, in the final stages of deployment. This requires conversations with Next Generation leadership around what their roles and responsibilities will be if the Founder is not available to give guidance and input.

Having a clear funding directive (specific organizations or issues areas) that was written with the Next Generation leadership at the table will make it easier for them to execute. This conversation will also allow for the emotional yet necessary discussions around family legacy, mortality and values to be had.

By engaging with the Next Generation early in the design and implementation of the funding scheme, the table is set for a successful transition of wealth and leadership, both at the foundation level and in the overall family wealth.

MANAGING RELATIONSHIPS AND EXPECTATIONS WITH GRANTEES

A standard sunsetting plan timeline for a foundation is two decades out from the intended closure. This allows for the Next Generation to assume the skills required to take on a leadership role at the Board level of the foundation and it provides a way to engage in Big Bets with current and potential grantees.

Grantmaking

Your grant-making decisions should include a mix of short, medium and long-term funding to the organizations in your funding portfolio. The flexibility of having a mix of term lengths allows for managing market fluctuations and also the changing needs of the community(ies) that you support.

For a grantee, nothing is more frustrating than having a donor restrict funding to an issue or program that no longer serves the needs of their clients, especially when they do not have the relationship or means to communicate with the Trustees or Board around changing the funding allocation. By drafting Donor Agreements that are not restricted to a specific activity, you entrust your grantees to make the operating decisions to achieve their mandate.

Photo Credit: Anna Shivet

Photo Credit: Cottonbro Studio

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Historical Documentation

One of the most respected foundation archives is that of the Rockefeller Foundation. Going back to pre WWII, philanthropy experts and researchers alike have used the Rockefeller Foundation Archive to better understand the historical context within which philanthropy was operating. This was most evident in shedding light on how philanthropy was used to shape America and Europe post-war; providing insights for future generations to consider as they engage in philanthropic activities.

The wealth transition plan should also include what gets archived from past grants. Documentation to consider keeping (digital or physical):

- **Past funding requests and decisions:** This is especially important for those foundations where the Founder can no longer share the decision-making history. For example, why a project or organization was not supported, or why a multi-year grant was not renewed. The archive may also include documents that explain the social/political environment within which these decisions were made. By keeping this history, and more importantly, having the conversation about how it is archived, the knowledge of the Founder and the values associated with the foundation will be passed on to the leadership that has the sunsetting responsibility.
- **Funding agreements and grantee correspondence:** This can provide future leadership and operations team members with examples of the tone and style of how the foundation communicates with its grantees.
- **Grant application forms:** These forms may have evolved with your foundation. Having a sense of what was asked of grantees in the past and what was deemed important to the foundation leadership can support future direction of the inheritors and/or Trustees.

SOCIETAL BENEFIT AND POPULATION LEVEL CHANGE

The argument made by some front line organizations for foundations to spend down speaks to the notion that front line agencies are better equipped and have tacit knowledge of the issues, whereas funders can be too far removed from the problem that is being addressed.

Organizations go further to say that if they have access to all the philanthropic capital available in the marketplace, and not just sporadic or project-based support, they will be better equipped to solve the issues they are mandated to solve and can do so in a timely fashion. The assumption being that if organizations are not busy trying to raise funds while also running the program they will not lose momentum on the program delivery. There is some merit to this argument.

Photo Credit: RDNE Stock Project

One of the age-old comments about Canada's charitable sector is that it is the "graveyard for pilot projects" in large part because funders tend to support new ideas and offer limited follow-along or scaling capital. The thought, therefore, is that if private and public foundations were not able to hold onto assets for multiple generations, then the access to working or scaling capital would be increased. This may be the case for some foundations, but for most, they are set up in part to manage taxes and overall family wealth planning and to ensure family legacy. These two needs require a multi-generational perspective on charitable wealth.

The Influence of the Structure of the Charitable Sector

It may be hard to think of the charitable sector as a market. However, consider this: there are 90,000+ charities in Canada and 1.5Million+ in the United States.

A marketplace is where there is an exchange of goods between a buyer and a seller. In the context of the "business of philanthropy," there are three entities participating in the transaction: the donor, the implementing organization and the client or end-user of the service. In some cases, the donor and the end-user may be the same person (e.g. patrons of the arts), but it is more common that the end-user has no connection to the donor (e.g. donors who support basic needs organizations).

Charities are registered with the federal government and are required to work ONLY on the mandate within which they have been approved. While this allows for a level of accountability of donor proceeds, it begs the question of an organization's ability to scale, its incentive to solve the problem (i.e. work itself out of the market), and its commitment to donor stewardship and partnership.

A funder who retains the assets within their foundation may be more inclined to understand the needs of their community/funding area and, consequently, pivot their funding regime based on shifts in the landscape. If the funds are fully released to an organization with limited (or no) accountability requirements, and the needs of the community shift, the grantee's ability to pivot and meet the changing needs even with this additional financial capacity may be limited by their mandate. We have also seen organizations burdened by too much capital too quickly resulting in wasted money and a breakdown in leadership.

The way that a donor operates within the charitable sector directly correlates to their philanthropic risk tolerance and the parties' assumptions surrounding the issue.

Foundations that take the time to build deep relationships with their grantees are able to design spend-down plans that empower an agency to make critical decisions without the constraints of donor wishes.

THE BUSINESS OF PHILANTHROPY

Like any corporate entity, there are operating costs associated with keeping a foundation running in perpetuity. Having a clear sense of your overall wealth plan will help you in the long-term when thinking about a multi-generational foundation.

As time passes, the Founder will no longer be responsible for the implementation of the charitable activities of the foundation. Eventually, it may end up that the inheriting generations, be they one, two or three generations removed, will not be at the decision-making table. At this point in time, there is typically a paid Trustee who takes on the board responsibilities of the foundation. Their compensation is directly correlated to retaining assets under management (AUM) and not necessarily on impactful philanthropic decision-making.

The business of philanthropy goes beyond the operating costs of the foundation; it also includes the costs of the implementing organization. The size of the agency and how much is deployed into the market at one time may have both positive and negative unintended consequences.

Photo Credit: Askar Abayev

Just as the foundation has operating expenses to manage its assets, so too does the receiving organization. Grantees need time to ramp up their operations when they are facing a large infusion of capital; conversely they may need to restructure their program if the capital is not replaced by another donor when the original funder pulls out. Another thing a grantee may need to consider, is how best to coordinate funding cycles with other donors to better leverage the donation they are receiving from the sunsetting foundation. And of course, recipient organizations also have the expenses associated with portfolio management.

Photo Credit: Liza Summer

GO BIG OR GO HOME

Big Bet philanthropy is when a foundation takes a moonshot on an idea, by either catalyzing a new solution or infusing an organization with substantial working capital that it can scale the solution for population-based change.

In order for Big Bet philanthropy to take place there needs to be reliable access to working capital. If a foundation is too narrow in its spend-down (i.e., selecting a couple of organizations or solutions to support), it runs the risk of limiting the long-term impact on the overall issue that it set out to address. However, if it is too broad by providing many small donations to several agencies, it loses its ability to take a stand on an issue.

Ultimately, the decision to take a moonshot is influenced by two things: family culture and Founder risk. As stated earlier, the Donor Risk Tolerance is the underlying influencer on how a Founder decides when, how and if their foundation will dissolve in their lifetime, shortly after their passing, or remain in perpetuity.

PROS & CONS OF SUNSETTING A FOUNDATION

Pros for Sunsetting	Cons for Sunsetting
Reduces the need for multi-generational foundation asset management	Multi-generational wealth planning may mean a loss of the financial decision-making meetings that bring family together
Founder retains control of decision making until the end	Transmission of family values may be obscured over time as the foundation no longer reinforces those values
Provides opportunities for greater immediate impact within the charitable sector	Reduces the pool of capital for organizations who may depend on long-term secure access to funding
Unburdens the Next Generation of decision-making	Disconnects the Next Generation from the relationships that the Founder(s) had with the grantees
Allows for funding pivots based on societal needs and quick response decision-making	Reduces the working capital that long-term/ relationship-based Grantees have access to
Provides organizations with a clear timeline of financial dependency and opens the door for conversations on Big Bet Philanthropy	Funder will lose the ability to leverage networks for additional support to organizations that have been de-funded
Allows for Moonshots or Big Bet risk	Founder may not see the results of the impact of a Big Bet and the inheriting generation may not have working capital set aside to continue supporting the growth ofthe Moonshot
Allows the Funder to celebrate the fruits of their labour while still alive!	

CONCLUSION

Whether to sunset a foundation or not is a multi-factor question that goes beyond financial commitments. A successful wind-down conversation should have all the players at the table, this includes both family and advisors. Others you may want to include in the discussion are your grantees and issue-area experts. There should be time spent considering the ripple effect of the closure and how that will be managed. Most importantly, include ways to celebrate the impact of the foundation and to celebrate its legacy.

As you can see, there are many moving parts. If you need assistance in managing your foundation through a sunsetting transition, the Karma & Cents team is here to help. We can be reached at: info@karmaandcents.com.

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