Philanthropy Roundtable

The Insider's Guide to Spend Down

James Piereson | Timeframe | 2002

Someone once jokingly referred to foundations as a pile of money surrounded by people seeking to spend it. There is a grain of truth in this comment, but philanthropists and foundation officers know that giving away money is no laughing matter. It may look easy, but it's difficult to do well.

That difficulty is compounded if you are required to spend large amounts of money in a short period of time. This is what is so challenging about spending down a foundation's assets. The great temptation is to focus simply on spending the money rather than on spending it well.

A few years ago, the John M. Olin Foundation began the process of spending down its assets in preparation for closing its doors. We are now well along this path, and we have learned a few lessons along the way.

Donor Intent

John M. Olin, our donor, was a businessman who served as a trustee of several universities, including Johns Hopkins, Washington University (St. Louis), and his alma mater, Cornell. He was a board member at Cornell in 1969 when a group of students armed with machine guns took over the student union. This incident led to some soul-searching on his part about the future of higher education and the free enterprise system in the United

States.

He saw clearly that the students at Cornell, like those at most major universities, were hostile to businessmen and to business enterprise, and indeed had begun to question the very ideals of the nation. He wondered if this situation could be reversed if these students, and the faculty members who encouraged them, could better understand the free enterprise system and our heritage of limited government.

So Mr. Olin decided to focus his philanthropy on programs and projects to strengthen the free enterprise system and challenge the then-prevailing anti-business orthodoxy. In the mid-1970s he chose key staff members, recruited a board of trustees, and gave the foundation a specific mandate. In 1977, he appointed William E. Simon, who had served as Treasury Secretary under Presidents Nixon and Ford, as the foundation's president. Bill Simon was an outspoken defender of private enterprise and critic of big government, and his appointment was a clear sign of the direction the John M. Olin Foundation would take.

Looking to the Future

In choosing Simon and the other members of the board, Mr. Olin was also laying plans for what would happen once he was no longer around. He was greatly influenced by Julius Rosenwald, an early advocate of the idea that foundations should spend their assets within a generation of their donor's demise. Olin was also guided by another event that took place in 1977—Henry Ford II's highly publicized resignation from the board of the Ford Foundation. Ford resigned out of frustration with that foundation's programs, which he said reflected little interest in or understanding of the system of private enterprise that had generated the foundation's wealth. The lesson Olin took from this public flap was that his foundation would likely come under the sway of people who did not share his principles. If this could happen to the Ford Foundation while a member of the family still served on the board, it could certainly happen to the John M. Olin Foundation.

His answer was to instruct his fellow trustees to liquidate the assets of the foundation over their working lifetimes. With the exception of Bill Simon, the trustees were John Olin's business associates; all of them understood what he was trying to accomplish. Most were roughly a generation younger than he was. The expectation was that the foundation might last for perhaps 25 years after Mr. Olin's death, just as Julius Rosenwald had recommended.

Mr. Olin had another reason for choosing to sunset his foundation: He wanted to influence contemporary thinking about economics and public policy, in the hope that the severe problems he saw could be corrected. It made little sense, in his view, to establish a perpetual foundation if these more immediate problems could not be ameliorated. His wish to end the foundation at some point has thus required the foundation to allocate the assets to current problems, rather than to those that might arise way out into the future.

John Olin died at age 90 in 1982. Sadly, our president, Bill Simon, passed away two years ago at age 72. The trustees Mr. Olin appointed, and those who joined the board after his death, are approaching an age that could fit the definition of "the end of their working lifetimes." It became clear that the time had come to wind down our operations. Today, we hope to spend or at least commit all of our remaining assets over the next three to five years.

Suicidal Spending?

When John Olin passed away in 1982, he left roughly half of his estate, or about $50 million, to the foundation; the other half was left to his wife with the proviso that any funds remaining at the end of her lifetime would revert to the foundation. Because of this proviso, we could not make any plans to go out of business while Mrs. Olin was alive.

The initial $50 million bequest from Mr. Olin was received in late 1982, just as the stock market bottomed out from that year's recession, and just in time for an 18-year market boom. By 1986, that initial $50 million had more than doubled to about $105 million. Our aggressive spending policies, however, reduced these assets to about $40 million by 1993.

When Mrs. Olin died in late 1993, another $100 million came into the foundation, at which point we began to lay plans to spend the remaining assets. I prepared a report for the board in December 1993, at which time we agreed to spend out the assets over a period of 10 to 15 years, or between 2004 and 2009. When Bill Simon passed away in 2000, we accelerated our plans. Right now we expect to close our doors in about four years, by the end of 2005.

In recent years, we have spent some $20 million annually on grants, or roughly 20 percent of our assets—four times the legal minimum payout rate. This very aggressive spending pattern is only possible because of our decision to spend down.

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Of course, we are prominent as one of the few foundations committed to developing and promoting conservative ideas. Our interests are diverse and include law, economics, foreign affairs, education, journalism, and public policy. About half of our grants go to university programs of various kinds. We have invested heavily in law and economics programs at leading law schools, in an effort to promote a deeper understanding of markets at those institutions. We have also supported programs designed to instruct federal judges in economics and economic reasoning.

A large share of our funds go to leading market-oriented think tanks, such as the American Enterprise Institute, the Heritage Foundation, the Manhattan Institute, and the Hoover Institution. We support a wide range of programs and projects, including books, fellowship programs, television documentaries, opinion journals, and so forth. We have made a strong effort over the years to bring conservative ideas into the intellectual mainstream of the nation, which is what John Olin wanted to accomplish.

Some friends have criticized us for spending down, likening it to suicide. We do not see it this way, but even if we did, we have no choice—it's what our donor required. Actually, the whole institution, trustees and staff, believe we are doing the right thing. Several of our most important accomplishments could only have been achieved through the kind of aggressive spending that our plan made possible. We prefer to think we are simply retiring or stepping aside, with the hope that others will step in where we have left off and continue to sustain the skillful, dedicated scholars, writers, and administrators who have used our funds to develop and communicate the ideas Mr. Olin intended to support.

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The Roads All Taken

Once a foundation decides to take itself out of business, there are different ways to make it happen. Some simply dissolve their boards, notify the IRS, and turn their assets over to a community foundation. Others make a few large donations to charitable institutions, such as universities or hospitals. Some foundations give their assets to another private foundation, in effect merging the two institutions. Others adopt a more gradual approach, setting spending schedules so that assets are depleted in a planned and orderly way over a period of years.

By the time we close, the John M. Olin Foundation will have used a combination of all these methods. We have been spending down in a gradual way for several years, but we also plan to make larger gifts to a few particularly effective institutions. Some of this money will be disbursed after we have closed our doors. We may set some of these funds aside in a trust, setting conditions on how and where it is allocated. Hence, our funds will continue to be allocated for perhaps four or five years after we have formally closed.

Our current strategy is to maintain our active grants program through the year 2003, with annual expenditures in the neighborhood of $20 million. As of October 2001, our assets were approximately $80 million. During these next few years, we will try to pare back our grant making and cease giving to institutions that can get by without our assistance. An organization that receives less than 5 percent of its annual budget from us can probably survive without our help. On the other hand, we think we should stick with organizations that are more dependent upon our support.

At some point in 2004, we will assess where we stand in terms of assets and commitments, and then begin the process of donating larger sums to a handful of organizations whose work is especially effective and important. These gifts will be designed to sustain these organizations and programs for a period of three to five years after we close, giving them an opportunity to seek funds elsewhere, and will probably be accompanied by a challenge provision. As always, we will not make endowment gifts.

We are now about halfway into the spend down process. We’ve been guided all along by a general plan that nonetheless gives us the flexibility to adjust to changing market circumstances and take advantage of opportunities as they arise.

Adjusting to Close

The decision to spend down colors everything a foundation does. Trustees will have to adjust the investment policy to reflect new needs. An institution that plans to exist forever can be heavily invested in stocks, given the long-term returns on those instruments. Such an institution can readily absorb and adjust to the ups and downs of the stock markets. But a foundation that plans to close in four or five years is in a substantially different position, particularly if it is making commitments to spend principal and to pay those pledges at a future date.

The problem is compounded by the fact that as a foundation spends down, its assets generally decline, while its pledges for future payment increase its assets generally decline, while its pledges for future payment increase. That makes it almost impossible to maintain a predictable stream of resources if the foundation's portfolio is entirely allocated to stocks. A few years ago, when we began to implement our plans, we changed our portfolio to a more equitable stock/bond mix. Last year, as we moved further along in our plans, we allocated 100 percent of our assets to a dedicated bond portfolio, which will allow us to plan our commitments with a fair degree of certainty that the funds will be there to cover them.

Our decision to close the foundation has also had implications for our grants program. Does it make sense to launch new programs if you will not be in a position to sustain them over a period of time? It can sometimes take five or ten years to begin a program and see it through to maturity. Once we developed a schedule for closing the foundation, we became much more reluctant to launch new enterprises. If a foundation does decide to spend down, it will likely have to warn nonprofits that have become dependent on its support. These warnings have to be credible, or there will be a natural tendency to believe that the day of reckoning can be indefinitely put off.

There are also important staffing issues. Given our long-range plans, we kept our staff small relative to our expenditure levels. Still, it is a challenge to retain valuable staff members when they know the organization will soon go out of business. Our board, in addressing this problem, has considered retention bonuses for a few key staff members. These would provide an incentive for employees to remain until their services are no longer needed.

A great challenge lies in avoiding what I would call "windfall" gifts—large awards that are made simply to dispose of the money. As a foundation nears the end of this process, with funds still available, it is easy to understand how staff and trustees might come to believe that the objective is simply to spend the money, rather than to spend it wisely on programs that advance

the donor’s intent. It’s a constant struggle to stick to our mission even as we bring the foundation to a close.

The End Draws Near

With the end now in sight, a number of new issues have arisen. How will we pay for grants that will extend beyond the life of the foundation? We plan to make multi-year grants to a few organizations that will be paid for a number of years after we are no longer in existence. There are various approaches to this challenge. For example, a trust can be created to receive the funds, with instructions as to how it should be disbursed and what conditions have to be met before the grants can be paid. Such a trust would have a small board that might meet annually for several years to approve such disbursements. However, it might be said that this simply extends the life of the foundation.

There is also the option of directing the funds to a community foundation or the like, which could then disburse the funds according to our board’s stipulations. We have yet to settle on any one option.

A multitude of organizational and regulatory issues remain to be addressed as the end approaches. Final tax returns have to be filed. Some funds may have to be kept aside for a time to meet unanticipated expenses. The physical assets of the foundation (computers, books, desks, and so on) have to be disposed of in some fashion. We also have to decide what to do with our important internal records and reports, some of which may involve our important internal records and reports, some of which may involve confidential evaluations of applications. Would such records be of interest to future philanthropists, foundation officers, or journalists? If so, should they be donated to a library or to a friendly research center, with instructions to make them available at some point in the future?

All of this then leads to a final question: Who will take our place once we are gone? We hope, of course, that other visionary philanthropists will come on the scene to continue the work that was started a generation ago by John M. Olin. This work continues, even though we will not, and it is perhaps more important today than it was 25 years ago. The John M. Olin Foundation, along with several sister foundations, such as the Scaife, Bradley, and Walton foundations, have shown what can be accomplished in the world of ideas with relatively modest sums of money. We have been speaking with other potential donors and philanthropists about just this subject. In the end, these efforts may prove to be among our most important contributions.

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