Fiducient Advisors, Nonprofit Investment Stewards Podcast
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Achieving Your Charitable Mission Through Private Foundations — With Adam Newell

[00:00:00] Welcome to Nonprofit Investment Stewards with Bob DiMeo and Devon Francis from Fiducient Advisors. Bob and Devon are passionate about helping nonprofit organizations prosper. Whether you oversee endowment, foundation or retirement plan investments, this podcast exists to help stewards improve performance, reduce costs and discover strategies that enable your charitable organization to prosper and advance its mission.

[00:00:26] Now onto the show. Hello, and welcome back to the Nonprofit Investment Stewards Podcast. I'm Bob DiMeo, always good to be joined by co-host Devon Francis. Today, we delve into a topic that is very important and candidly, probably a bit overdue in addressing. We're going to enter the world of high-net-worth families and more specifically private foundations.

[00:00:52] I'm pleased to share that one of mine and Devon's extremely talented partners at Fiducient is joining us. Before we introduce him, Devon, good to be with you. How are things today? Things are great, Bob. Thank you. We're so excited to have our friend and colleague Adam Newell on the show today. Adam is a partner at Fiducient as well as the director of consulting in our Wealth Office.

[00:01:14] In addition to strategic oversight for our private client practice, Adam also provides investment expertise to a number of high-net-worth families, private foundations, and nonprofit clients as well. He's a voting member of the firm's investment committee. He is a Certified Financial Planner and a CFA charter holder.

[00:01:33] My introduction to Adam was on a Zoom happy hour where he was dressed as Joe Exotic from the Tiger King. So, he is a man who wears many hats. He also serves as a volunteer board member with several nonprofits and he even co-founded a charitable organization. So I could go on and on, but instead we'll start the show.

[00:01:53] Adam, welcome. Thanks, Bob. Thanks Devon. It's a pleasure to be here. So Adam, can you share with us how your career led you to becoming [00:02:00] director of the Wealth Office at Fiducient and advising high net worth families? Absolutely, Devon. It's interesting that this is the question we're leading off with. As my parents were visiting from out of town this past weekend and asked me actually a similar question as we were reminiscing.

[00:02:16] And the short story is both of my parents are teachers and my sister is in fact a social worker. So, I believe that I have a bit of helping people in my DNA. And on top of that, I'm also a math geek. Back in my high school and early college days, I actually wanted to be a high school math teacher, but became interested in personal finance and economics in college.

[00:02:40] So it became a natural fit for me to land in my career today in wealth management, really, it's the perfect intersection of helping people and still get it to use math. Boy, it really is. And Adam, perhaps you can provide in just a brief overview of The Wealth Office at Fiducient Advisors and what you do.

[00:03:00] [00:02:59] Absolutely. So it's an interesting arc. I've been with the firm nearly 20 years and I can't stress enough how proud I am of the tremendous growth that I've seen within our Wealth

Office. So in terms of what we look like today, we help over 400 families and we manage or oversee about 17 billion in assets.

[00:03:19] But I think most importantly, the caliber of my colleagues, the professionalism and that diverse backgrounds really affords us the opportunity to help our clients prosper. So shifting to private foundations, let's set the table here. What type of individuals or families are typically involved with private foundations and why?

[00:03:39] Devon, that's a really great question to start off with. I think I want to dispel a myth right out of the gate. And that is when you hear the term private foundation, I think naturally, wealthy individuals think about the Rockefellers or the Warren Buffets or the Bill Gates of the world, because those are really the poster child for [00:04:00] family foundations.

[00:04:01] But in actuality, that's not, those are the exceptions, not the rules to who typically would create a family foundation. And so what do I mean by that? Well, interestingly, if you look at the number of family foundations out there today, 88% of all family foundations have less than 5 million in assets. So, if you think about the headlines of the Gates foundation, right?

[00:04:25] Lot of assets are in those foundations, but those are the exceptions. So I think when you look at the typical family, it's not the Bill Gates or Warren Buffett's, it's an average family that's looking to endeavor in a charitable mission and have maybe a million to $5 million in assets to do so. Can you talk a bit about the difference between a private foundation and a donor advised fund and which vehicle or which entity might be right for a particular family?

[00:04:57] Yes, that's a question we do get [00:05:00] quite often, and it is very complex and customized, given what the family wants to achieve. But if you think about in a foundation formation, there is some legal structure that needs to be done. So typically, a CPA or an attorney would need to get involved to draft things like articles of incorporation, get a tax identification number and such, and then there are tax filings involved with running that foundation.

[00:05:27] So it's a bit more of a heavier lift than perhaps a donor advised fund, which is a bit easier to set up. And if you look at where clients and wealthy families typically involve donor advised funds, you can do it through custodians like Fidelity or Schwab or Vanguard, so less administrative burden for the donor advised fund.

[00:05:49] But here's the key difference between the two. A foundation allows control, right? Family has control over disbursements, over board of directors, over the [00:06:00] investments involved in the foundation. And that's a benefit. Whereas in a donor advised fund, typically, there's some restrictions on gifting. You're actually not a charity.

[00:06:11] You're making recommendations on where your dollars go to. And so, you leave a little bit of control on the table in trade-off for the less complexity. And Adam, are there thresholds? I know it varies. But, and you can have, as you mentioned, a three or $4 million private foundation, and we'll work with clients with a hundred million and more in that space, but are there sort of natural thresholds that you view in terms of generally speaking, a donor advised fund might make sense to this point and then a private foundation above that amount?

[00:06:46] We do. I think in general, $10 million dedicated to a foundation would make it economically viable, right? Because of the additional costs and the complexity involved. And then, smaller balances, I [00:07:00] have hundred thousand to a million upward to that $10 million mark, a donor advised fund likely is the simpler, cheaper, easier path.

[00:07:08] And what about time horizon? So I know when Bob and I deal with our non-profit endowment clients, perpetuity is the end goal. Is there a difference in the way that you approach working with private foundations or with donor advised funds? Is it a perpetual time horizon or is there a finite goal? Does it even matter what the time horizon is?

[00:07:29] It doesn't matter. It's a really good question, Devon, and something that when we engage in our, in a discussion with our families, that's one of the first questions we ask, right? And why do we ask that question out of the gate? It's because it has some other decision criteria along with that. For example, if you want to be in perpetuity, then you want to make sure that you've got maybe a second generation or third generation of family members that will want to be involved in that foundation.

[00:07:57] And if you don't have a bit of that legacy in your [00:08:00] family, it may be more and more difficult to exist as a foundation in perpetuity if you sort of run out of family members down the line. Now that being said, we do work with families that have multiple generations that are involved in their foundation, but out of the gate, they have made the decision to spend down the assets during the lifetime of the first or even second generation.

[00:08:24] So there is no hard and fast rule, but it is going to be a discussion that I would suggest every family has when they set up a foundation is to determine, is this a perpetual organization or do we want to spend down? And both of those are equally appropriate. Adam, given you're an expert, maybe we can get a little inside baseball here.

[00:08:45] And what are just some of the best practices as it relates to the oversight, the operations of a private foundation, and maybe what are some of the pitfalls that you would really try to help families navigate and avoid? So [00:09:00] really good question, in terms of best practices as we've touched on a little bit on a family foundation side, there are some administrative burdens that you need to overcome in terms of formation.

[00:09:11] But when you do finally get over that hurdle and you've got your foundation up and running, there are some things that we would suggest that get done on a regular basis. So what does that mean? So for example, policies and procedures, right? It's very important to have meetings and have meeting agendas and have meeting notes, right?

[00:09:31] It's very important for the board members to understand their responsibilities and the biggest challenges that a family really does not anticipate until they get into the weeds of their foundation and that's grantmaking. Right? It seems very easy for us to say I've set up a foundation. I now have assets to give away.

[00:09:51] This should be fun. Right? Let's just start writing checks to various charitable organizations. And oftentimes, families run into a little bit of a [00:10:00] challenge because it's not that easy. If you think about having a family foundation, you will likely get solicited by outside grantees. And so there needs to be a process in place on how you as a family foundation are going to handle grantmaking.

[00:10:15] For example, how many grants do you want to make a year? How large should those grants be? Or even something as simple as who at the foundation will be evaluating those grants? So having some of those best practices regarding those policies and procedures, I think is key because it's very difficult then to give away money without those policies.

[00:10:36] And then of course, and we can do this a little bit more detail, but there are things like how do we set an appropriate investment policy statement? How do we determine board membership in terms of the different generations that might be involved? So there is a litany, Bob, of best practices besides just giving away the money.

[00:10:56] And Adam, have you seen some families you're talking [00:11:00] about, you know, kind of orchestrated participation here, right? That I can envision some families, this really being a wonderful, ongoing perpetuation of sort of the family and maybe the original founders of this private foundation. And then others, I could see it perhaps being a bit of a challenge in terms of obtaining participation and such. Any thoughts on that?

[00:11:26] Yes, I would say, communicate, communicate, communicate right. As you establish a family foundation, oftentimes there's the first generation that sets up a foundation with their own mission and priorities and charitable goals. And to your point, Bob, those may change over the course of subsequent generations.

[00:11:50] So to give you an example, we work with a foundation where the initial mission of the organization was social service and community impact. That was [00:12:00] generation one's mission. And as generation one passed and generation two took over, they switched the mission to more environmentally friendly practices.

[00:12:08] So if you are embarking in creation of a foundation, I would absolutely encourage families to communicate, communicate, communicate, because as families change, as dynamics change, obviously the mission and the priorities may change alongside that. That's good advice in life. Not just within the private foundation realm.

[00:12:31] What about excise taxes and a UBIT, unrelated business income tax? So what can you do about those things? Well, Devon, the misnomer is that a family foundation is a tax exempt entity, which is true, but I think a lot of foundations don't realize there is an excise tax, as you just mentioned. Now, it used to be upwards of 2%.

[00:12:53] But a foundation could pay an excise tax that could be reduced to 1% based on some activities. However, in [00:13:00] recent legislation, that's been moved to just a flat 1.39%. Now, unfortunately the bad news is it's you can't get it to zero. So, an excise tax is something that foundations should be aware of. On the UBTI front, that's just a tax on investments in a portfolio that generate income that's a little bit different than traditional stocks and bonds.

[00:13:24] And so it's much easier to eliminate the UBTI tax drag by making better investment decisions. And that's something that the foundation board absolutely can control and can absolutely get to zero. Adam, let's unpack the investment side a little bit more.

[00:13:42] You're an investment advisor. We are investment advisors. Talk a little bit about the general structure you'll see in terms of the investment allocation and such, the use or lack thereof of alternative investments, within the private foundation space. [00:14:00] So in terms of an appropriate investment policy, this is where the spending policy of the foundation comes into play.

[00:14:08] And we haven't touched on this yet, but it's important to understand that a private foundation does have a mandate to distribute 5% of their portfolio every year. And so if you think about that from an investment policy standpoint, and we talk about this in three levers, I know you've alluded to this in other podcasts.

[00:14:28] It's a powerful exercise to go through the three levers because we know we have a 5% mandatory spend. So that's going to drive most of the allocation decisions with the family to say, okay, if we're distributing 5% and we want some growth and we want some inflation protection, maybe we need to have an investment portfolio that's diversified to earn us a 7%, let's say.

[00:14:53] And coincidentally, if you look at studies from resources, like the common fund and the Kubo, the [00:15:00] typical target rate of return for many family foundations is exactly that 7%. So that then allows us on the investment side of the table to help a family build and construct a portfolio of cash and hedge funds to achieve that five to 7% rate of return.

[00:15:19] So it's very similar to what a traditional nonprofit would go about doing or even a private client in their own portfolio. So Adam, the markets have performed remarkably well in recent years. Many foundations have earned more than that 5% return objective. What are the options if a foundation can't make the annual 5% mandatory distribution requirement?

[00:15:41] That's a good problem to have, right Devon? Outpacing your investment objective. I think the most powerful, but I would say somewhat unknown or at least under the radar technique to mitigate that circumstance, Devon, is what we affectionately would call a sidecar donor advised fund. [00:16:00] And why we call it that is that remember, as I mentioned earlier, a private foundation has a 5% mandatory spend.

[00:16:09] And in the situation Devon that you just described, the investments are earning more than 5%. So, it may be tough for a foundation to be able to spend all of that money, right. Again, a good problem to have obviously, but because the IRS mandates that 5%, it has to be distributed. So having a donor advised fund as an outlet for those extra distributions is a great tool.

[00:16:33] And why is that? Well, if you don't have enough charitable bequests to make that 5%, you can put the remainder that you have in spend into the donor advised fund. So, it satisfies the 5% mandatory distribution, but you're not forced to make donations to places that you may not have fully vetted or want to donate.

[00:16:56] So having the dollar sitting in a [00:17:00] donor advised fund gives the foundation a ton of flexibility because they've met the 5%, but aren't forced to make distributions they're not ready to do. So we would suggest many foundations have what we call the sidecar donor advised fund as a great flexibility tool to make sure that they align with the 5% spend mandate and not getting into any trouble with the IRS.

[00:17:24] And what are some of the pitfalls? And you're talking about the IRS, maybe IRS red flags that families should try and avoid with the private foundation. I think the biggest one, and we hear about this all the time in the media.

[00:17:39] It gets a lot of attention, would be what they describe as self-dealing. So think about a family foundation where somebody on the board wants to take an MBA class or a trip to a third world country to better understand hunger. Well, there are times where we've seen a foundation, a private

[00:18:00] foundation pay for that MBA class or that trip to the third world country for a family member.

[00:18:06] And that's a no-no. And so the IRS would flag that as essentially self-dealing. There are also some other red flags, one of them being a disqualified person, meaning that you can't contribute if you're a family member, officer and affiliated with the foundation, you really can't do business with the foundation.

[00:18:29] And so we call that a disqualified person. So those are probably two of the biggest ones we see often, and it gets all of the headlines. So Adam, you've covered a lot today. It's been incredibly helpful, very insightful. Is there a closing thought or some words of wisdom that you would share with the listeners?

[00:18:48] Well, number one, I would say, don't watch the Tiger King. It's not a great show. I have to disagree with you on that one. You were funny. Yes. But you know, [00:19:00] seriousness, I think it's a weighty discussion and it's a weighty decision that a family needs to make.

[00:19:05] So for a family that is charitably inclined, I would just stress that it's important to think about not only how to give, but what to give and when to give, because those three pieces are going to help you really achieve maximum impact both within your family, but also with your charitable mission. So if the family can keep those three guideposts in the back of their head, I think they're set up for success.

[00:19:32] Adam, this has been super insightful and you and I have known each other a long time. You're wonderfully talented and have a terrific family. Let's just talk for a moment before we let you go about Adam Newell, the person, and perhaps you can share with all of your professional commitment and all of your volunteer efforts, what do you enjoy doing separate from work and volunteer efforts?

[00:19:56] I think most people that know me well and Bob, [00:20:00] I'd throw you in that category, know that I'm a passionate bike rider. I own five bicycles myself of different elk. So if, if I'm not on a board, at work, hanging out with my children and family, you can likely be seeing riding a bike around town. So that's really a passion of mine and has the benefits of being a little bit, keeps me healthy, but also affords me a little bit of alone time.

[00:20:26] So I can think about things like family foundations and being a partner at the firm. So it's great zen time and keeps me fit. And so I would say bike riding is a passion and that's what people know me for. Adam, thank you so much for joining us today. You have provided so much valuable information. We are really appreciative of your time and your expertise.

[00:20:48] If folks listening would like to learn more, want to access some resources, perhaps contact you, how would they go about doing that? Absolutely Devon. Feel free, anybody [00:21:00] can reach out to me directly via our website or my contact information in the show notes. You can also find me on LinkedIn and so really feel free to reach out in any way, shape or form.

[00:21:11] And I would say whether you're a family foundation, a wealthy family, a family office, even a nonprofit, we'd love to hear from you. And I'm always happy to be a resource. Well, Adam, we are so appreciative. Thank you so very much. And thanks so much to our listeners. For you nonprofit leaders overseeing investments and if I had to make a bet, I'd guess that your portfolio has some combination of both active and passive or index type investments.

[00:21:39] Our research experts at Fiducient have conducted a lot of analysis on the topic of active versus passive. And I can tell you the landscape is absolutely shifting. If your committee is curious, maybe you're trying to determine what asset classes make sense.

[00:21:55] Then please know, we are happy to share a matrix that we created and some other [00:22:00] resources that identify what we believe should be indexed. And then also the asset classes where we definitely suggest avoiding indexing. You can reach out to me or Devon on LinkedIn or at the email address in the show notes.

[00:22:14] So to all you good stewards, thanks for investing time to help your nonprofits prosper. We'll connect with you soon on the next episode. Thank you for listening to the Nonprofit Investment Stewards podcast. Click the subscribe button below to be notified of new episodes and visit fiducientadvisors.com for more information. The information covered and posted represents the views and opinions of the guests and does not necessarily represent the views or opinions of Fiducient Advisors.

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