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TAX LAWS POPULARIZE THE SMALL FOUNDATION

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By Geraldine Fabrikant

When John Lane III assumed the investment responsibilities for the Edward H. Lane Foundation in 2004, he took on a lot of headaches.

The foundation, which had been started by his grandfather, was a small fry — worth just \$1.2 million — in a world dominated by behemoths like the \$37.3 billion Bill and Melinda Gates Foundation and the \$13 billion Ford Foundation. But Mr. Lane had the same basic need as those big fish: a good investment strategy. And he was not happy with how the investment manager had been handling the foundation's funds.

“I could do just as mediocre a job myself at less expense,” Mr. Lane said.

So Mr. Lane eventually got rid of the firm and hired Scott & Stringfellow, an independent brokerage firm, for the foundation, which focuses its giving on education and research.

The number of smaller foundations and other charities like Mr. Lane's has exploded recently. According to the Urban Institute's National Center for Charitable Statistics, there were 76,849 private foundations — of all sizes — at the end of 2005, the latest year for which data is available. That represents a 49 percent increase over the number in 1995.

Still, the amount of money in most private foundations is often minuscule. In fact, at the end of 2005, 67 percent of all private foundations had assets of less than \$1 million and 27 percent had assets of \$1 million to \$10 million.

Timothy Walter, chief executive of the Association of Small Foundations, with 3,100 members, said the acceleration in the formation of foundations is directly linked to the increasing wealth in the stock market as well as an “awareness that a private foundation gives you flexibility in when and how you give away money.”

Changes in the tax laws in the 1990s have also played a role. Thomas E. Chomicz, a lawyer who specializes in charitable organizations at Quarles & Brady in Chicago, said that the law now allows donors to deduct the fair market value of public stock transferred to a private foundation rather than just deducting the cost of the stock.

That means a donor who gives stock to a foundation that cost \$10 a share but is now worth \$500 a share can deduct the entire \$500 from his gross income, subject to some tax limitations.

While those rules had also been in place in the 1980s, they did not become law until 1998. “I think that was a catalyst for the creation of — and contributions to — private foundations,” Mr. Chomicz said.

But donors often have loftier goals in mind and want their foundation to play a continuing role in their particular area of interest. And whatever the financial returns, every foundation is required by law to give away at least 5 percent of its assets annually.

Given the recent turmoil in the stock market, producing strong enough returns to generate money to give away as well as increasing the value of the foundation may be getting even more challenging. “The volatility that we have seen in the market recently underscores how important it will be for a foundation to manage its money well,” Mr. Walter said. “That 5 percent payout discipline creates a critical challenge for a foundation.”

John Lane’s brother, Landon Lane Jr., together with their sister, manage the \$1.5 million L. B. Lane Family Foundation, which gives to a variety of causes. Landon Lane said the work can be labor intensive, adding: “The vast majority of people on these committees do not have the time or expertise to do it. Being a nonprofit board director often requires a lot more time and attention than people can spend.”

Landon Lane said he runs the family foundation himself. Although he has a master’s degree in business from the [University of Virginia](#) and worked in his family’s furniture manufacturing business before it was sold in 1987, he said that he has sought more training at the American Association of Individual Investors.

While the amounts of money that foundation board members are responsible for may seem small, the idiosyncratic nature of some foundations can create their own set of pressures.

Floyd Keene, president of the \$1 million Triple EEE Foundation, said of his foundation, “Frankly, we are too small potatoes for any big national firms.” Investment options for his foundation “are a lot less than they are for a foundation with \$100 million,” he said.

Indeed in recent years the minimums required at many investment houses have risen. Cambridge Associates, for instance, which provides investment advice and research to nonprofit organizations, among other clients, does not take any foundations with less than \$50 million in assets. And to compound the investment hurdles, Mr. Keene wanted to invest only in vehicles that are in keeping with his foundation’s mission: building self-esteem through education and exercise. That rules out, for example, any companies that rely on sweatshops, he said.

As a result, Mr. Keene has worked with two smaller firms, dividing the assets between Stifel Nicolaus and Rothschild Investments. He wanted to go to two firms because, he said, “if you read about what happened at places like [Bear Stearns](#), you don’t want to trust just one firm.”

Although larger Wall Street firms do take foundation money, there are some more specialized groups that work with smaller foundations. But even they have minimums that can seem high.

One financial adviser with strong ties to the foundation world is the Investment Fund for Foundations, an organization founded in 1991 to help foundations improve investment returns and give them access to some of the nation's top money managers.

Its board is now led by Jane Mendillo, who was named this year to oversee the Harvard Endowment, and also includes Seth Alexander, who oversees the endowment at the Massachusetts Institute of Technology. Jack Meyer, the former head of the Harvard Endowment, who now runs Convexity Capital, a \$6 billion hedge fund, was a board member for many years.

Yet the Investment Fund for Foundations has a minimum of \$5 million because of securities laws, aimed at protecting smaller, less sophisticated investors. Clients of the fund get access to some hedge funds, including Convexity and Farallon. Investors in Farallon have included Yale.

Commonfund, a nonprofit investment manager focused on investments for other nonprofits, also has a minimum, though it is \$1 million.

David Salem, founding president of the Investment Fund for Foundations, recommended that people who want to put less than \$1 million into a foundation look at donor-advised funds run by big mutual fund and community foundations. Investors get the benefit of the tax deduction for their investment and then direct where and when the proceeds are donated.

It all comes back to the increasingly popular idea that index funds are perhaps the least glamorous but the most useful option for smaller investors, whether institutions or individuals.

“It can cost as much as \$10,000 to administer even a \$1 million private foundation,” Mr. Salem said, alluding to accounting and audit costs. “If it is a really small foundation, then I believe that the Vanguard index funds are a good starting point because you get broad diversification at low cost.”