

Program-Related Assets under UPMIFA

UPMIFA does not apply to “program-related assets.” This brief article explains why the Drafting Committee chose to exclude program-related assets, the meaning of the term under UPMIFA, and the effect of excluding these assets from the scope of UPMIFA.

Why Does UPMIFA Exclude Program-Related Assets?

UPMIFA does three things: provides guidance for investment decision making, provides rules for spending from endowment funds, and provides rules for the modification of donor restrictions. The Drafting Committee decided that applying the prudent investor rules of UPMIFA to the buildings a charity uses to carry out its charitable purposes might be confusing, and for that reason decided to exclude a category of assets called “program-related assets.” For example, a university may own classrooms, laboratories, and dormitories. Decisions about buying new buildings, renovating existing buildings, and managing those buildings will be governed by standards of prudence, but saying that the university should approach decision making with respect to those buildings as a “prudent investor” might seem puzzling to an administrator. The land might be more valuable if used for another purpose, but the university would need to keep the buildings for use by its faculty and students.

What is a Program-Related Asset?

Section 2(5)(A) of UPMIFA defines a program-related asset as “an asset held by an institution primarily to accomplish a charitable purpose of the institution and not primarily for investment.” Of course, all funds held by a charity are held to carry out the charity’s purposes (or should be), so this definition does not mean that a fund used to pay for scholarships or to buy food to distribute to those in need is a “program-related asset.” If the dollars of a fund are used to pay for charitable activities, the fund will be governed by UPMIFA. Thus, almost all funds held by charities will be governed by UPMIFA.

The exclusion for program-related assets applies to tangible or real assets held by a charity for direct use in its charitable activities and, for a charity engaged in micro-finance as its charitable purpose, to a fund used to make loans. The laboratory equipment owned by a university, the house owned by a homeless shelter, and the food storage building and food preparation equipment owned by a soup kitchen are all program-related assets. These assets all have monetary value, and a charity might decide to sell assets of this sort and use the proceeds of the sale for another charitable purpose, but the charity uses the assets primarily to carry out the charitable activities of the charity. A fund used by a micro-finance charity to make low-interest loans might also be used “primarily to accomplish a charitable purpose.”



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Most assets held by a charity will either be clearly program-related assets or investment assets. Nearly all funds held by a charity are governed by UPMIFA. The funds may be used for operating expenses, may serve as an endowment for scholarships, or may be a development fund to be used to pay for a new building. All of these funds are institutional funds under UPMIFA. Sometimes, though, an asset may have a mixed purpose and determining whether the asset is a program-related asset may be more difficult. Two examples may help describe this sort of asset.

In the 1990s the area around Trinity College had become depressed and unsafe. The College bought properties adjacent to the College and began to provide low-interest loans to businesses willing to develop the properties. The College did not intend to use the properties directly for its educational purposes, and the low-interest loans were not the primary purpose of the College, but the College anticipated that revitalizing the area near the campus would result in benefits for the community and would likely increase student applications. Viewed entirely from an investment perspective, the acquisitions and loans would likely not have been prudent, but these uses of College resources made sense because they provided a degree of investment potential as well as other benefits for the College.

Micro-financing organizations use charitable funds to make loans to people who cannot otherwise obtain loans. The loans may be made to people with poor credit ratings and may be made with interest rates lower than market rates. The charity's program-related asset is a pool of money – not usually the form a program-related asset takes – because the dollars are used to carry out the charitable purpose. Even if a fund used to make loans is a program-related asset, the Comments remind the charity that the charity should create standards for the program to increase the likelihood that the loans will be repaid.

UPMIFA does not preclude a charity from acquiring and holding assets that have both investment purposes and purposes related to the organization's charitable purposes. Indeed, UPMIFA directs the decision maker to consider the purposes of the institution and of the fund in making investment decision. Thus, a prudent decision maker will take into consideration these charitable purposes in making an investment that may have a program-related purpose but not be primarily program-related, and a decision-maker should consider investment factors even in making a decision about an asset that is primarily program-related. The degree to which an institution uses an asset to accomplish a charitable purpose will affect the weight given that factor in a decision to acquire or retain the asset. UPMIFA does not intend, however, that a charity use a tangential charitable purpose as an excuse for failure to engage in prudent decision making with respect to an investment. A charity should not justify an imprudent investment by later asserting that the investment is somehow related to the charity's purposes.



What is the Effect of Treating an Asset as a Program-Related Asset?

If an asset is a program-related asset, UPMIFA does not apply to the asset and other state laws will govern decision making with respect to the asset. A charity must manage all of its non-investment assets under the prudence standards that apply to directors of nonprofit corporations or trustees of charitable trusts. For example, the Revised Model Nonprofit Corporation Act provides that directors must act “in good faith and with the care an ordinarily prudent person in a like position would exercise.” A university must take care of its buildings, must make informed decisions about purchasing or selling buildings, and must manage the buildings with its educational purposes in mind. The fact that UPMIFA does not apply to these non-investment assets does not have a significant impact on the fiduciary duties of the directors or trustees with respect to those assets but changes the priorities to be considered. The charity’s charitable purposes will take priority over any investment potential in the asset, and the fact that the asset presents risks or is likely to produce a low return will be countered by its importance to the activities of the charity.

A program-related asset will, by definition, not be an endowment, so the fact that UPMIFA’s endowment spending rules do not apply to the asset has no impact on the asset. UPMIFA’s modification rules will not apply to a program-related asset, and a charity will look to other state law if the charity needs to modify a donor restriction. A charity must comply with any donor restriction imposed on a gift it accepts. This well-established rule pre-dates UPMIFA, and UPMIFA does not change the requirement that a charity must follow donor restrictions. UPMIFA provides that the modification rules developed under trust law – the rules of cy pres and deviation – will apply to funds governed by UPMIFA. Courts have applied those trust rules to assets held by nonprofit corporations in the past, and a court might do so with respect to a restriction imposed on a program-related asset, but the charity would have to rely on the common law.

For example, assume that a donor gave a painting to a museum organized as a nonprofit corporation and not as a trust. The donor stipulates that the museum must always display the painting as part of its collection, that the painting cannot travel to other museums, and that the museum cannot sell the painting. The painting is a program-related asset, so UPMIFA does not apply to the painting. If the museum needs to modify the restriction, perhaps to permit the painting to be exhibited by other museums as a way to raise money to care for the painting, the museum may be able to use the common law doctrine of cy pres to request the modification. The museum will not be able to rely on the statutory authority for judicial modification provided under UPMIFA. The fact that the painting is a program-related asset does not affect the donor restriction, but it may affect the availability of court-ordered modification.



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Conclusion

Although UPMIFA excludes program-related assets, the Drafting Committee did not intend to suggest that charities could act imprudently with respect to their program-related assets. Rather, UPMIFA recognizes that some charities use assets directly in carrying out their charitable purposes and that the application of prudent investment rules may not be appropriate as a way to guide the directors in making good decisions about the assets. If an asset has both an investment purpose and a charitable purpose, the charity should be conscious of both types of purposes in making decisions. If a charity has a fund it uses in paying for its charitable activities, investing in assets which may have a tangential charitable purpose should not be used as an excuse for failing to follow UPMIFA's prudent investment guidance.

