**What Constitutes a Charity’s Permanent Endowment?**

* What is permanent endowment?
* How to identify permanent endowment
* Types of permanent endowment

**What is Permanent Endowment?**

* Permanent endowment is property (e.g. land or funds) held by a charity on the basis that the charity’s trustees only have the power to spend the income produced by the property, and not the underlying capital assets or funds
* The capital must be preserved in perpetuity

**Why create Permanent Endowment?**

* To safeguard property to benefit future generations (e.g. village hall, almshouses)
* To provide the charity with a secure income to fulfil its purposes (e.g. grant-making charity - bursaries, etc)

**The Charities Act 2011 - current definition of Permanent Endowment**

*“A charity is to be treated for the purposes of this Act as having permanent endowment unless all property held for the purposes of the charity may be expended for those purposes without distinction between -*

*(a) capital; and*

*(b) income;*

*and in this Act “permanent endowment” means, in relation to any charity, property held subject to a restriction on its being expended for the purposes of the charity.”*

**The Charities Act 2022 - new definition of Permanent Endowment**

When the relevant provisions come into force permanent endowment will be defined as property that is *“…subject to a restriction on being expended which distinguishes between income and capital…”*

This is intended to capture any fund held subject to a restriction that the capital cannot be expended by any means.

The new definition will not capture:

* Special trust property, such as a fund held subject to a restriction that it can only be expended on a specific purpose; or
* A fund held subject to a general restriction that only a certain percentage of it (whether capital or income) can be spent each year.

**How to Identify Permanent Endowment**

* Not always easy to identify
* Necessary to interpret the charity’s governing document
* Charity Commission operational guidance: [*g545a001 Identifying and Spending Permanent Endowment (charitycommission.gov.uk)*](http://ogs.charitycommission.gov.uk/g545a001.aspx) - examples of wording indicating that an asset might be permanent endowment
* Might also be necessary to examine additional documents which brought the charity into being or transferred the assets into the charity (e.g. conveyances, wills and historical evidence of the donor’s intention)
* The Charity Commission takes a flexible approach to identifying permanent endowment and will consider all the evidence provided
* ***Presumption of permanent endowment?*** General assumption that if the charity’s governing document gives a clear power to spend income, but is silent on spending of the capital there is a presumption of permanent endowment. However, necessary to consider all the relevant information and documentary evidence
* Mistakes can be made - *expendable endowment* can be wrongly designated as permanent endowment (and vice versa)
* “Expendable endowment” is identified as capital in the accounts, but unlike permanent endowment the trustees have power and discretion to decide to spend it
* Trustees should check assumptions and ask questions if in doubt

**Types of Permanent Endowment**

* Investment permanent endowment
* Functional permanent endowment

**Investment Permanent Endowment**

Asset used to produce income for the charity to be spent on fulfilling its purposes (e.g. investment portfolio, shares to generate dividends).

Charity can sell the investment to purchase more investments, but the funds generated by the sale (including any capital growth) must be kept and reinvested by the trustees to continue to produce income for the charity.

Some almshouse charities may have investment portfolios that are investment permanent endowment in addition to permanent endowment land and buildings.

**Functional Permanent Endowment**

Asset which must be used for a specific purpose of the charity but may not necessarily produce an income or substantial income.

Functional endowment can be:

* ***alienable*** - property that can be sold and replaced with similar property on the condition it is used for the same purposes, but the proceeds of sale cannot be spent
* ***inalienable***- property whereby if disposed of the charity’s purposes could no longer be fulfilled (e.g. designated land or specie land)

Necessary to check the charity’s governing document and any other relevant documents to identify whether the functional permanent endowment is alienable or inalienable.

**What Rules apply to Permanent Endowment?**

Before looking at trustees’ statutory powers to deal with permanent endowment, trustees need to identify their charity’s permanent endowment and understand the provisions of their charity’s governing document which apply to it.

Examine the charity’s governing document and any other relevant documents to identify if assets are permanent endowment and, if so, what type of permanent endowment and any applicable conditions which apply to the use of that asset

Common for almshouse charities to have both functional permanent endowment and investment permanent endowment.

* ***Functional permanent endowment***where the charity’s governing document requires properties to be used as almshouses and retained indefinitely; and
* ***Investment permanent endowment*** to generate income to maintain the almshouses or to provide additional facilities or assistance for the benefit of the residents

**Investing Permanent Endowment**

**Implications for trustees managing permanent endowment funds**

Standard rules require the trustees to reinvest capital gains arising from the investment as capital and only income receipts may be spent on fulfilling the charity’s purposes.

Requirement for trustees to distinguish between income return, which can be spent, and capital growth, which cannot.

Problemifinvestment income is low and capital gains are high - the charity could be left with insufficient income to fulfil the charity’s purposes for its current beneficiaries, but the underlying capital continues to grow.

Inflexible - duty to balance the needs of current and future beneficiaries and therefore funds must be invested to balance income return and capital growth. This may not produce the best overall return.

*Charity Commission Guidance: Charities and investment matters: a guide for trustees (CC14)*

Unless the governing document gives the trustees a specific power to exercise their judgement when allocating investment receipts between capital and income the standard rules apply and trustees cannot take a total return approach to investment.

However, trustees can adopt a total return approach to permanent endowment funds by passing a resolution to adopt regulations made by The Charity Commission (known as **“the Total Return Regulations”**).

**Total Return Regulations**

*Charity Commission Guidance: Total return investment for permanently endowed charities*

**Adopting a Total Return Approach to Investment**

Trustees may only pass a total return resolution if they are satisfied that this is in the charity’s best interests.

The total return resolution may apply to all or part of any of the charity’s available endowment fund.

If the available endowment fund is not all subject to the same trusts, separate total return resolutions will be needed for each part that the trustees want to be governed by the Total Return Regulations.

**Initial Considerations**

Before passing a total return resolution trustees must obtain and consider proper advice about how to exercise the statutory powers pursuant to the Total Return Regulations unless they reasonably conclude that in all the circumstances it is unnecessary or inappropriate to do so.

“Proper advice” is obtained from someone who the trustees reasonably believe to be qualified to give it by their ability and in practical experience of investment and relevant matters.

Advisable for trustees to obtain proper advice ***before*** passing a total return resolution ***and***when they are considering how to deal with the permanent endowment after passing a total return resolution and adopting a total return approach unless they reasonably conclude this would be unnecessary or inappropriate.

**Total Return Resolution**

Trustees are required to resolve that all or part of the charity’s permanent endowment should be invested without the need to maintain a balance between capital and income returns, and that it should be free from the restrictions with respect to expenditure of capital that apply to it.

If the total return resolution is passed, the framework in the Total Return Regulations will apply.

There are no specific rules on the content or format of the total return resolution although it must be made in accordance with and pursuant to the rules and procedures in the charity’s governing document.

The Charity Commission recommends that the resolution and the minutes record the following information to explain the rationale for the trustees’ decisions including:

- identifying the relevant fund that would be subject to total return investment;

- whether an existing Charity Commission Order is being discharged and if there are any outstanding recoupment directions;

- the date of the valuation of the relevant fund

No requirement to notify The Charity Commission that a total return resolution has been passed.

**Valuation - Total Return Approach**

To adopt a total return approach, the trustees are required to identify a value for the investment fund by attributing a value to the relevant fund when it was created and any additions of capital to it since then (“the investment fund”) and the assets that represent return on the endowment, including unspent income plus any capital gain, since that date (referred to as “the unapplied total return”).

This division of the permanent endowment fund between the investment fund and the unapplied total return forms the basis for the new treatment of the fund and its investment using the total return approach.

The Charity Commission emphasises that it does not expect trustees to carry out a complex tracing exercise.

Instead, it expects the trustees to make a reasonable estimate of which resources represent the unapplied total return.

What is “reasonable” will depend on the charity’s circumstances, such as the amounts involved and the state of its records. However, trustees should record how they have made the decision and the calculations and factors taken into account.

Once trustees determine the value of the investment fund and the unapplied total return, they are not able to alter it and therefore The Charity Commission recommends that trustees take advice from the charity’s accountants in making this decision.

**Allocating Unapplied Total Return to the Income Fund**

* Unapplied total return only becomes available to spend when it has been allocated to the income fund and any unallocated funds must be treated as permanent endowment (i.e. added to capital)
* Any part of the unapplied total return that has been allocated to the income fund must be used by the trustees for the charity’s purposes within a reasonable period

**Allocating Unapplied Total Return to the Investment Fund**

* There is a cap on how much of the unapplied total return can be dealt with in the above way, based on the inflationary increase in the value of the investment fund
* Decisions about what part of the unapplied total return should be allocated to the investment fund subject to the cap must be compatible with the trustees’ duty to further the charity’s purposes both now and in the future

**Total Return Approach**

**Spending and Replacing**

The trustees have power to release some of the funds held in the investment fund to be used as income and spent on pursuing the charity’s purposes, subject to the following rules:

* The amount released must not, at any time, bring the total of the sums released to more than 10% of the value of the investment fund
* The amount they release must be recouped. The trustees must decide how long and at what rate to recoup the amount released

**Reporting and Trustees’ Duties under the Total Return Regulations**

Trustees have specific duties to fulfil when adopting and exercising total return investment powers:

* Use reasonable care and skill when exercising both their total return investment power and other duties under the Total Return Regulations, taking into account any special knowledge they may have or hold themselves out as having
* Obtain and consider proper (independent) advice about the way in which their power should be used, unless they reasonably decide having considered all relevant factors that it is not necessary to do so
* Exercise their powers in such a way as, acting in good faith, they reasonably believe will not prejudice the ability of their charity to fulfil its purposes now and in the future
* Provide information in the trustees’ annual report for each financial year about how they have applied the total return approach to investments. To include:

- an explanation of how the value of the investment fund was established;

- the date from which income and gains were allocated to the unapplied total return.

- an explanation of the considerations and policies used to determine what amounts of the unapplied total return to allocate to the income fund and the investment fund during the financial year;

- an explanation of the considerations and policies used to decide to allocate any part of the permanent endowment to the income fund; and

- the name of the person who gave advice on those decisions

If the trustees are not required to prepare an annual report, this information must be provided in the notes to the charity’s accounts for the relevant financial year.

**Total Return Regulations**

**The Charities Act 2022**

Gives trustees power, once they have opted into investing on a total return basis under the Charities Act 2011, to further release permanent endowment restrictions to allow them to make social investments with a negative or uncertain financial return.

Will amend The Charities Act 2011 to enable The Charity Commission to make new regulations to govern the use of permanent endowment funds to make social investments.

Will amend The Charities Act 2011 to ensure that trustees have a power to use permanent endowment to make social investments that would contravene the restrictions on spending capital, where they have opted in to the new power to future release permanent endowment restrictions to allow them to make social investments with a negative or uncertain financial return.

**How can Permanent Endowment be Spent?**

**Rationale:**

If a fund is very small and that the costs of administering it are greater than the income it produces and it would be in the charity’s best interests to spend the fund or combine it with other funds.

The trustees may decide that it would be in the charity’s best interests (and the best interests of the beneficiaries) to spend all or part of the charity’s permanent endowment now.

**Spending Permanent Endowment**

The trustees may be able to spend permanent endowment in the following circumstances:

* Using the statutory powers in the Charities Act 2011 which enable trustees to release the restrictions over permanent endowment in prescribed circumstances. These powers are only applicable to investment permanent endowment.
* By obtaining an Order or a Scheme from The Charity Commission where the statutory power cannot be used. Can apply to investment and functional permanent endowment.
* By adopting a total return approach to investment pursuant to the Total Return Regulations. Applies to investment permanent endowment.

**Statutory Powers to Spend Permanent Endowment**

The procedures which are applied to spend permanent endowment using the statutory powers in The Charities Act 2011 depend upon whether the fund is a small fund or a large fund.

These procedures will be updated when the relevant provisions of The Charities Act 2022 come into force.

Currently, the procedures are applied to “unincorporated charities” in The Charities Act 2011 (e.g. charitable trusts or unincorporated associations).

The Charities Act 2022 removes the reference to “unincorporated charities” to remove any doubt about whether the statutory powers are available to incorporated charities like charitable companies and CIOs.

**Small Fund**

A smaller permanent endowment fund can be spent using the following procedures:

A resolution can be passed by the trustees if any one of the following applies:

* [The charity’s gross annual income in its last financial year did not exceed £1,000]\*
* The market value of the entire endowment fund is up to [£10,000]\* [\*to be increased to £25,000]

Such a resolution takes effect immediately and does not require The Charity Commission’s prior approval or public consultation.

\*Changes made by The Charities Act 2022

**Larger Fund**

A larger permanent endowment fund can be spent using the following procedures:

**Conditions**

All of the following conditions must be met:

* *[The charity’s gross income in its last financial year is over £1,000\*] [to be removed]*
* The market value of the entire endowment fund is over *[£10,000\*][to be increased to £25,000]*
* “Market value” means:

 - the market value of the fund as recorded in the charity’s accounts for its last financial year, or

 - the current market value of the fund as determined on a valuation carried out for the purpose.

* *[The fund is “entirely given”\*] [to be removed]*

\*These provisions will be removed/amended when the relevant parts of The Charities Act 2022 come into force. So use of the statutory power thereafter will only depend on the market value of the fund and whether its market value exceeds £25,000.

The Charities Act 2022 also provides that the amount of any outstanding borrowing from permanent endowment is taken into account when calculating the value of a fund for the purpose of determining whether it falls above or below the £25,000 threshold for obtaining The Charity Commission’s consent.

**Larger Fund**

**Resolution**

The trustees must first satisfy themselves that the purposes which apply to the permanent endowment fund could be more effectively carried out if the capital as well as the income can be spent.

The trustees must then pass a resolution that the permanent endowment fund, or any part of it, should be freed from the restrictions on spending the capital.

The Charity Commission must be provided with a copy of the resolution (by the trustees completing an online form) and then has *three months\* [The Charities Act 2022 reduces this period to 60 days]* to decide whether to agree with it - commencing when it receives it.

It can require the trustees to give public notice of the resolution or provide additional information or explanations about it.

When does the resolution take effect?

* When The Charity Commission agrees with it or if the *three month period\* [to be reduced to 60 days]* passes without The Charity Commission responding
* The period runs either from the date on which The Charity Commission receives the copy of the resolution, or, if it has required the trustees to give public notice from the date when that notice was given.

**Charity Commission Order**

If, for any reason, trustees cannot use the statutory powers, an application can be made to The Charity Commission for an Order to authorise permanent endowment to be spent.

The Charity Commission will only usually make an order to enable trustees to spend permanent endowment where the statutory powers cannot be used or it would be impractical for trustees to use the statutory powers and it is expedient in the interests of the charity.

**Conditions which may be place on the Order**

The Order may direct the trustees to recoup any spent permanent endowment out of income within a specified period (e.g. ten or more years), therefore replacing and replenishing it.

The order cannot sanction anything that is expressly prohibited by the charity’s trusts or governing document or change the purposes of a charity. That would require a Scheme.

Where recoupment is required, the charity is, in effect, borrowing from its permanent endowment rather than spending it.

**Applying for an Order**

When applying for an order to authorise spending permanent endowment, The Charity Commission would expect the trustees to explain the following:

* Why they are unable to use the statutory powers to release the spending restrictions.
* What the purpose of the expenditure is, and how long it will have an effect (e.g. if it is to fund proposed building works what the timetable for these is)
* The benefits that they expect the charity to derive from spending the permanent endowment
* How much permanent endowment they intend to spend
* Why permanent endowment needs to be used and what other funding options they have explored
* How the needs of the charity’s existing and future beneficiaries have been balanced
* The period over which they plan to replace the permanent endowment and by what method (e.g. setting aside a sum annually)
* How replacement is possible based on the charity’s finances
* Where appropriate, why they consider that replacement should not be made

If it is not clear if the relevant property is permanent endowment, The Charity Commission may be prepared to make a comfort order giving the trustees authority to spend the property if, and in so far as it is needed, but The Charity Commission may not always be prepared to do this.

**Making a Scheme**

If The Charity Commission cannot make an Order (e.g. if doing so would contravene anything in the charity’s governing document), it may be possible for it to make a Scheme under The Charities Act 2011 to authorise spending permanent endowment in the following circumstances:

* To permit the sale of land that is subject to an express prohibition against being sold
* Spending the proceeds of functional permanent endowment outside of its intended purpose

**Permanent Endowment**

**Charity Incorporations and Mergers**

If an almshouse charity wishes to incorporate as either a charitable company or CIO then if it holds permanent endowment assets it is usually structured so that the permanent endowment continues to be held on trust, with the charitable company or CIO becoming the sole corporate trustee of that trust.

It is possible for the permanently endowed fund and the corporate charity to be linked for registration, accounting and reporting purposes so that they are treated as one charity.

This can be achieved either:

* By applying to The Charity Commission for a direction under the Charities Act 2011
* Automatically (unless The Charity Commission specifies otherwise) where a pre-merger vesting declaration is used to vest legal title to permanent endowment in a CIO to hold on trust as sole corporate trustee
* Recommend that trustees of permanently endowed charities seek professional advice on incorporation so that it is clear how the permanent endowment assets shall be treated post-incorporation and which mechanism is appropriate to ensure that the transfer of assets is appropriately handled

**The Charities Act 2022**

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**Questions**