

Madison Investments Spending Rate Policy Review

How Sustainable Is Your Spending Rate?

An overlooked component of many investment policies is the sustainable spending rate level. The spending rate methodology and its implementation are critical components of both the asset allocation decision as well providing stable cash flows to your organization during periods of market stress and shifting market return expectations.

Spending Rate Considerations

The chart in the upper right compares the average spending rates for the different types of non-profits. Important considerations in determining your spending rate policy include:

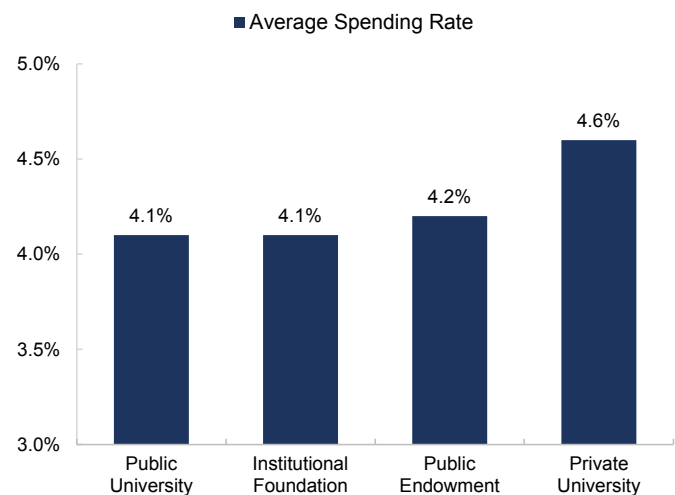
- **Public vs. Private:** Private foundations are required to spend at least 5% per year, whereas Public non-profits are not subject to minimums.
- **Goals:** Annual cash flow needs to support your current work as well as the future goals of your organization. Degree to which the organization is reliant on the portfolio to support its mission.
- **UPMIFA² Regulation:** Adopted in most states, this act guides spending rate and asset allocation.
- **Hurdle Rate:** To maintain the purchasing power of your asset pool, inflation must be considered. A hurdle rate is your spending rate plus inflation.

Implementation Method

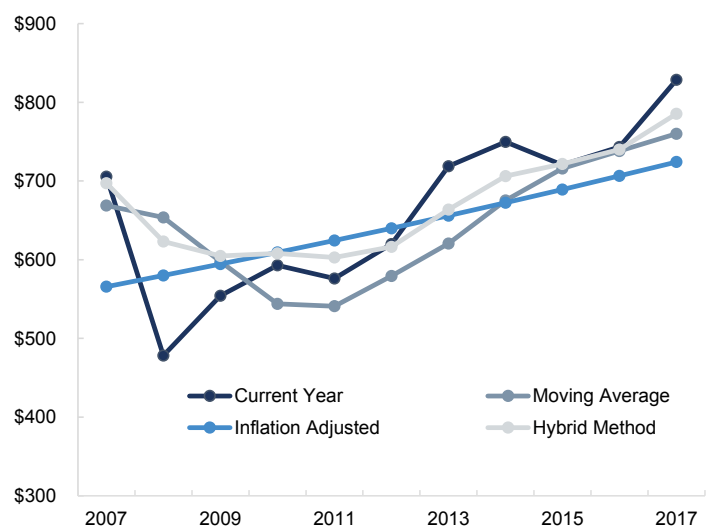
Once the spending rate is determined there are a variety of ways in which it can be implemented. The commonly used methods differ by the variability in spending year-over-year.

- **Current Year:** The previous year-end balance is multiplied by current spending rate.
- **Moving Average:** Multiply the spending rate by an average balance, typically 12 quarters.
- **Inflation Adjusted:** Grow the distribution each year at a predetermined inflation rate (typically CPI). As presented, this method does not take into account principal fluctuations of the endowment due to portfolio allocation.
- **Hybrid Method:** Average of 60% of the prior year's spending amount adjusted for inflation and 40% of the previous years ending balance multiplied by the spending rate.

2017 NACUBO¹-Commonfund Study of Endowments



Annual Spending Values: \$10M Endowment at 5%



This assumes that principal of the endowment was invested during these times periods in the following portfolio allocation: 65% S&P 500, 10% MSCI EAFE and 25% Barclays Aggregate. Assumed inflation is 2.5%.

1. The National Association of College and University Business Officers (NACUBO)-Commonfund Study of Endowments is an annual survey of U.S. college and university endowments and affiliated foundations. www.nacubo.org

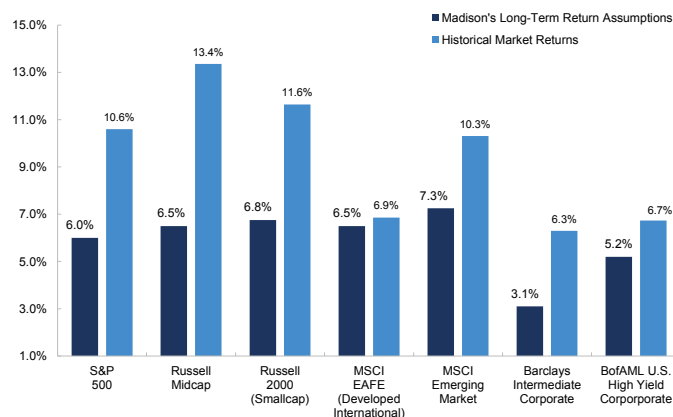
2. Uniform Prudent Management of Institutional Funds Act (UPMIFA) governs investment of funds of charitable organizations and total return expenditure of those funds. www.upmifa.org

Future Market Expectations

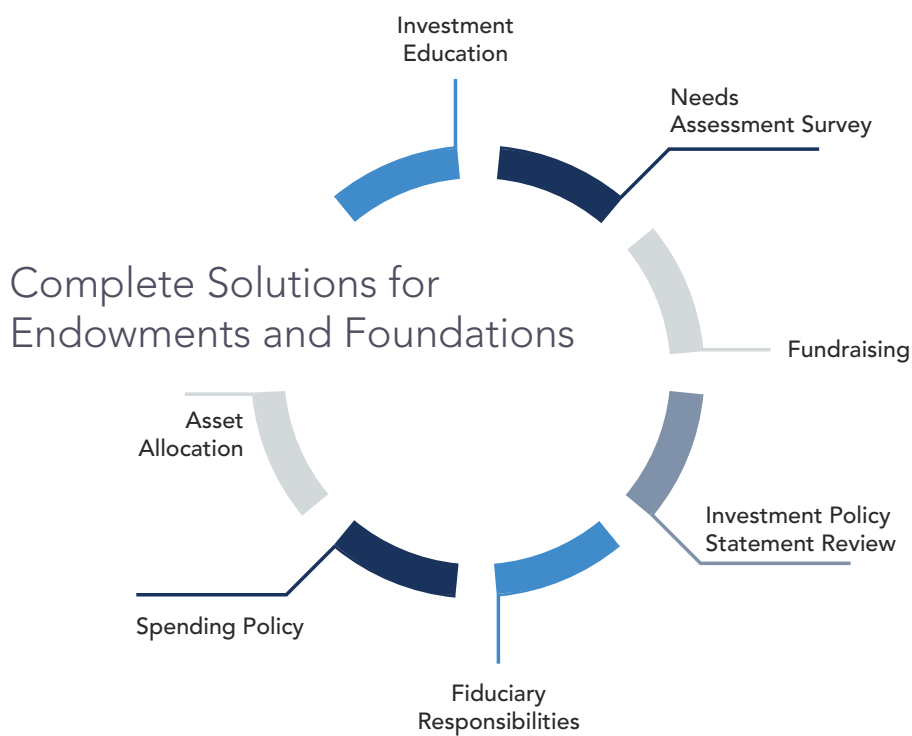
For many reasons current forecasts for investment returns are subdued, calling into question asset allocation and spending rates. Policies that worked well in the past may require change. As a result many clients are reconsidering:

- Spending Rates
- Asset Allocation
- Ways to Increase Donations

Madison's Expected Market Returns vs. Historical Returns



Madison's proprietary return assumptions are forecasted returns for the next 7-10 years. Madison's return expectations are based on historical market returns, future market outlook and peer comparison, they are our estimate as of the date of this piece and are not guaranteed. Historical market returns are the annualized since inception returns for each index. (Source: Morningstar Direct)



Madison Investments - Customized Investment Solutions

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