



PHILANTHROPIC SERVICES

ENDOWMENT SPENDING POLICIES

Any prudent financial steward seeking to ensure the long-term success of the endowment must construct a detailed **ENDOWMENT SPENDING POLICY**. Such a policy determines the flow of funds from the endowment's operating budget. A well designed policy will aim to take into consideration the primary objectives of the endowment. For example, this may include a need for a steady stream of short-term cash flow and the long-term goal of growth to out-pace inflation. Ensuring the endowment's goals are addressed by the spending policy requires a well-constructed **INVESTMENT POLICY STATEMENT**.

TYPES OF SPENDING POLICIES

- I. **SIMPLE MARKET VALUE:** Involves a flat spending amount or rate which is subsequently applied annually to the portfolio's market value.

$$\text{CURRENT PORTFOLIO VALUE} \times \text{SPEND RATE}$$

- II. **INFLATION-BASED:** Sets spending to grow based on an inflation adjustment, typically the Consumer Price Index (CPI), in order to out-pace real-world changes.

$$\text{PRIOR YEAR'S SPENDING} \times (1 + \text{INFLATION})$$

- III. **SMOOTHING:** Involves a moving average method based on prior years' market values. This method provides for more stable spending than simple, flat-rate.

$$\frac{\text{SUM OF PRIOR 3 YEAR'S PORTFOLIO VALUES}}{3 \text{ YEARS}} \times \text{SPEND RATE}$$

- IV. **HYBRID:** Combines two spending policies, weighing the importance of each based on the overall goals of the endowment. Consider the hybrid spending rule used by Yale University.

$$80\% \times (\text{PRIOR YEAR'S SPENDING} \times [1 + \text{INFLATION}]) + 20\% \times (\text{CURRENT PORTFOLIO VALUE} \times \text{SPEND RATE})$$

So how should an endowment go about choosing a spending policy? That process starts with a deep discovery—understanding the organization's chief concerns—both financially and emotionally—to understand what makes them tick. *What are their objectives, risk tolerances, liquidity needs and any tax and/or unique circumstances?* This information is organized in an **INVESTMENT POLICY STATEMENT**—so that the investment portfolio remains aligned with the organization's mission. Here at **ALINE WEALTH** we take great care in constructing a living, breathing document that is regularly reviewed and updated to keep pace with any changes that may arise.

Source: Vanguard Group, Inc.

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