VII. STANDING COMMITTEES

B. Finance, Audit and Facilities

Amendment to the Statement of Investment Objectives and Policy for the Consolidated Endowment Fund

RECOMMENDED ACTION:

It is the recommendation of the Finance, Audit and Facilities Committee that the Board of Regents adopt a new spending policy for the Consolidated Endowment Fund (CEF). The recommended policy change will replace the interim spending policy which impacted program distributions in fiscal years 2009 and 2010.

The recommendation is summarized below:

1. **SPENDING RATE:** Reduce total spending (program distributions plus administrative fees) by one percentage point representing a drop in the long term spending rate from 6.0% to 5.0%.

2. **SPENDING SPLIT:** Reduce the rate on program distributions from 5.0% to 4.0% and maintain the current administrative fee of 1.0%.

3. **ADMINISTRATIVE FEE SPLIT:** Maintain current 1% administrative fee at 80 bps to the Advancement Program and 20 bps to the Investment Office.

4. **AVERAGING PERIOD:** Extend the averaging period from three years to five years.

5. **TIMING:** Next quarterly distribution following Board approval.

6. **IMPLEMENTATION:** Implement to a five year averaging period incrementally over a twenty quarter transition period. Beginning with the second quarter during the transition, distributions will be smoothed through the use of a 5% collar on quarter to quarter increases or decreases.

7. **ADMINISTRATIVE FEES' CALCULATION:** Change administrative fee distribution from period end calculation to the same averaging formula used for program distributions.

Amendment to the Statement of Investment Objectives and Policy for the Consolidated Endowment Fund (continued p. 2)

8. **ADMINISTRATIVE FEE REVIEW PROCESS:** Initiate annual review of administrative programs (Advancement and Investment Offices) funded off the CEF by the Office of Planning and Budgeting. Identify process for ongoing administrative program oversight.

BACKGROUND:

In March 2009, the Board of Regents approved an interim spending policy that lowered then froze program distributions at approximately half that of fiscal year 2008 levels. The action was taken to prevent further erosion of the endowment following the severe meltdown in global financial markets in the last half of 2008. The Board's intention was to review the spending policy on an ongoing basis and reinstate the long term spending policy no later than 6/30/2013. Valuations have improved significantly over the past year and while not fully restored, it is reasonable to consider a return to a long term spending policy at this time.

SPENDING POLICY OBJECTIVES:

An effective spending policy will meet the following objectives:

- Balance the competing needs of current and future endowment beneficiaries;
- Maximize the stability and predictability of distributions;
- Be understandable and acceptable to donors and campus.

SPENDING POLICY COMPONENTS:

The most commonly used spending policies have two components:

- **Spending Rate:** The annual amount withdrawn from the endowment expressed as a percentage of the endowment's market value.
- **Spending Rule:** The formula for determining annual spending withdrawals and the mechanics of its implementation. The spending rule is designed to reduce annual variability in spending – typically by applying the spending rate against an average multiyear endowment market value.

Amendment to the Statement of Investment Objectives and Policy for the Consolidated Endowment Fund (continued p. 3)

RATIONALE:

To facilitate decision-making, the recommended action is broken into its component pieces, which are summarized below:

9. **SPENDING RATE:** In its 2010 CEF annual asset allocation review, UWINCO advised the Board of Regents to reduce the total spending (program distributions plus administrative fees) on the CEF from 6.0% to 5.0%. The recommendation from UWINCO was informed by general economic conditions suggesting a prolonged low return environment.

10. **AVERAGING PERIOD:** The longer averaging period has the benefit of dampening market volatility during market extremes – providing higher levels of support when markets are down and lower levels of support when markets are up. A longer averaging period also facilitates forecasting and allows programs to effectively plan for change.

11. **TIMING:** Departments have been severely affected by state budget cuts. Endowments are an increasingly important source of funding for the programs they support. Increasing spending from its current 3.2% to 4.0% will provided a much needed boost in support. Endowment operating account balances declined 1.3% from 6/30/08 to 6/30/10. The decline seems slight when viewed in total. But many departments function with very little in reserve and the decline in some programs is as much as 70%. Endowments providing scholarships and fellowships are particularly affected.

12. **IMPLEMENTATION:** Management of the transition to the new spending policy is critical. It is recommended that the averaging period be implemented incrementally; increasing one quarter each period until the twenty quarter (5 year) average has been attained then rolling forward. Beginning with the second quarter during the transition, distributions will be smoothed through the use of a 5% collar on quarter to quarter increases or decreases.

13. **ADMINISTRATIVE FEES' CALCULATION:** Prior to the recommended change, distributions to administrative programs were based upon the current quarter end market value. This resulted in high

Amendment to the Statement of Investment Objectives and Policy for the Consolidated Endowment Fund (continued p. 4)

quarter to quarter variability in the distribution. Approval of the recommended action will result in the use of the same spending calculation for both program distributions and administrative fees.

14. **ADMINISTRATIVE FEE REVIEW PROCESS:** Reviews of the administrative programs funded by the CEF (advancement and investment offices) will be conducted by the Office of Planning and Budgeting annually.

REVIEW AND APPROVALS:

This policy recommendation has been reviewed by the Senior Vice President and the administration, the Chief Investment Officer and by the University's investment consultant, Cambridge Associates.

Attachment
Consolidated Endowment Fund Spending Policy Review

Consolidated Endowment Fund Spending Policy Review

A Report to the Board of Regents

October 21, 2010

Treasury Office

University of Washington

F-10.1/210-10
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Consolidated Endowment Fund Spending Policy Review

A Report to the Board of Regents

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Treasury Office
University of Washington

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Executive Summary

In exercising its fiduciary responsibility over the University of Washington's investment program, the Board of Regents makes two key policy decisions: strategic asset allocation and spending. Changes to the strategic asset allocation of the CEF were approved by the Board at its May 2010 meeting. The focus of the October 2010 Board meeting is on endowment spending.

- **Interim Spending Policy:** In March 2009, the Board of Regents approved an interim spending policy that lowered then froze program distributions at approximately half that of fiscal year 2008 levels. The action was taken to prevent further erosion of the endowment following the severe meltdown in global financial markets in the latter part of 2008.

- **Campus Impact:** The pain felt by endowed programs was tempered for some departments by their reserve balances and/or the continuing generosity of their donors. Scholarships and fellowships were the most heavily impacted and anecdotal evidence suggests that further declines in the number and size of awards lie ahead. Over the past year, many donors expressed disappointment that their endowed programs have not been better supported.

- **Recommended Action:** Adopt a new long term spending policy that sets total spending (programs distributions plus administrative fees) at 5% of the average market value of the CEF for the previous five years.

- **Implementation:** The five year average will be implemented incrementally. After the initial quarter, the quarter to quarter change in the distribution level will be capped at 5% as a way of smoothing the distribution to campus and as protection in volatile markets.

What is the Governance Structure of the CEF?

The Board of Regents of the University of Washington is vested by statute with responsibility for the management of the properties of the University, including the Consolidated Endowment Fund and other University funds.

Investment program oversight resides with the Finance, Audit and Facilities Committee (FAF), a subcommittee of the Board of Regents. In May 2001, the Board approved the establishment of an advisory committee, the University of Washington Investment Committee (UWINCO), consisting of Board members and external investment professionals. In 2004, the Board approved the appointment of the University's first Chief Investment Officer (CIO) to manage the day to day activities of the investment portfolios.

From the "Statement of Investment Objectives and Policy for the Consolidated Endowment Fund"

What are the Key Roles and Responsibilities

Board of Regents	University of Washington Investment Committee (UWINCO)	Chief Investment Officer (CIO)
Sets Investment Policy	**Advises the CIO**	**Implements investment program**
• Spending rate	• Investment planning	• Day-to-day management
• Strategic asset allocation	• Asset allocation	• Tactical asset allocation
• Delegations	• Manager identification	• Manager appointments
	• Market trends	• Manager terminations
Appoints investment officers / advisors		• Risk management
• Chief Investment Officer	**Advises the Board of Regents**	• Research
• UWINCO Members	• Investment program oversight	
• Investment consultants		**Monitors results**
		• Performance reporting
Review results		
• Program oversight/accountability		

Governance of the investment program is defined around clearly established roles and responsibilities.

The University of Washington Consolidated Endowment Fund

In 1905, the University of Washington received its first cash endowed gift of $400, thus beginning the accumulation of endowed funds that are held today. By June 30, 2010, the University of Washington's endowment totaled $1.8 billion and contained 3,334 individual endowment funds. Approximately 80% of the funds held in the Consolidated Endowment Fund (CEF) are endowed by the donor and/or department and can be used solely to support designated programs. The remaining 20% consists primarily of long-term operating monies invested by policy in the CEF by the Board of Regents.

The CEF currently funds scholarships and fellowships (28%), professorships and chairs (25%), research (9%), general academic support (18%) and other university activities (20%). Nearly half of the endowment benefits the overall University, with the remaining focused on specific units, including Academic Medical Affairs (24%), Arts and Sciences (12%), Engineering (7%), and the Business (5%) and Law (4%) Schools.

Individual endowment funds are commingled in the CEF for investment purposes and unitized much like a mutual fund. Distributions to endowed programs are made quarterly.

Over the past ten years, the CEF provided $648 million in endowed program support. This represents approximately 2% - 3% of the University's annual operating revenues.

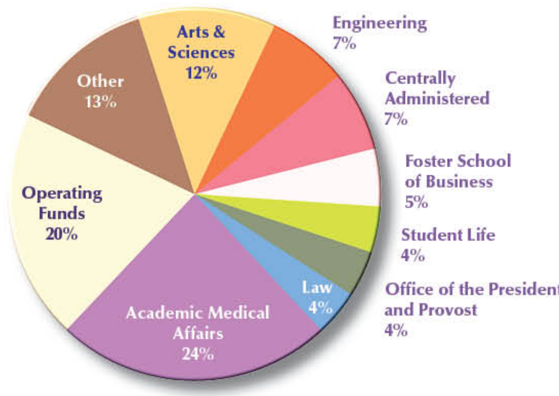
What are the Characteristics of the CEF?

As of June 30, 2010

Endowed Program Support

Principal by Purpose

Principal by School and College

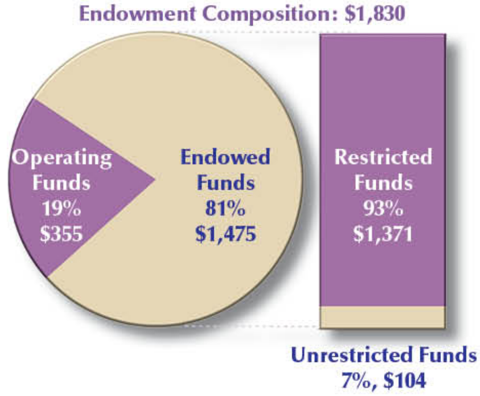


Endowment Distributions as a % of Total UW Revenues

Fiscal Years	Annual UW Revenues	Endowment Distributions	%
2005	$3,025	$62	2.0%
2006	$3,455	$70	2.0%
2007	$3,666	$81	2.2%
2008	$3,427	$94	2.8%
2009	$3,054	$75	2.5%
2010		$59	

Endowed Dollars Distributed

Endowment Composition: $1,830



What are the Characteristics of a Good Spending Policy?

A spending policy should strike a balance among the following objectives:

- Provide programs with a predictable and stable stream of revenue
- Maintain the purchasing power of this revenue stream over the long term
- Maintain the purchasing power of endowment assets over the long term
- Be understandable

A spending policy should include:

- A target spending rate
  - Balances current and future program needs
  - Does not exceed the average real investment return over the long term
- Spending rule or formula
  - Reduces the annual volatility of spending
  - Keeps spending within sustainable limits

Source: Cambridge Associates

These objectives are typically met by establishing a spending rate consistent with the institution's tolerance for risk. A higher spending rate requires a higher allocation to equities. Stability in the distribution flow is managed through the use of a smoothing mechanism, commonly three to seven years average market value, to soften the disruptive impact of short term capital market volatility.

What is the CEF Spending Policy?

Interim Spending Policy:	Per unit distributions to endowed programs were decreased by 25% in both FY '09 and FY '10 after which distributions are held constant at the FY '10 level. This interim policy went into effect in March 2009 and will be revisited by the Board of Regents no later than June 30, 2013 to determine the appropriate next steps.
Long-Term Spending Policy:	Spend 5% of the average market value of the CEF for the previous three years.
Core Concept:	*Intergenerational Equity*: This concept balances the needs of current and future beneficiaries. It requires policies that allow spending to change at approximately the same rate as inflation without impairing principal over the long term.
Frequency:	Distributions are administered on a quarterly basis.
Policy Changes:	Changes to the spending policy require approval of the Board of Regents.
Other Spending (Fees):	A 1.0% annual administrative fee is charged against the endowment: 0.8% to the Advancement Office and 0.2% to the Investment Office.

The interim spending policy was approved by the Board of Regents in March 2009, and retroactive to the beginning of fiscal year 2009. The action was taken in response to the extreme volatility and downward price pressures in the financial markets in the latter half of 2008 which ultimately resulted in a 23% drop in endowment values in FY09.

How has the Spending Policy Changed Over Time?

Period	Spending Policy	Administrative Fees
Pre- 1988	All interest and dividend income	15 bps to Treasury
1988	5% of a three year moving average market value	15 bps to Treasury
1989-1990	5% of a three year moving average market value	30 bps to Treasury
1990-1998	5% of a three year moving average with year over year change in distributions limited to 5%	30 bps to Treasury
1998-2001	5% of a three year moving average with year over year change in distributions limited to 5%	20 bps to Treasury 20 bps to Advancement
2001-2009	5% of a three year moving average market value	20 bps to Treasury 80 bps to Advancement
Current ***(Interim Policy*)***	Fixed distribution of $2.35 per unit per year (42% of FY08 distribution level)	20 bps to Treasury 80 bps to Advancement

** Interim policy approved by the Board of Regents in March 2009 and retroactive to the beginning of FY09.*

What Impact has the Interim Policy Had on Schools and Colleges?

Prior to the adoption of the interim policy, many departments accumulated distributions on new endowments for the first year or two as the program was established. As a result, endowment operating accounts grew steadily along with new gifts. Endowed operating balances declined in FY09 and were flat in FY10.

Fiscal Year	% Increase (Decrease) in Endowed Operating Balances
FY07	12.8%
FY08	15.0%
FY09	-1.4%
FY10	0.1%

Which Endowed Programs Drew Down their Operating Balances Since the Spending Cut?

The largest drop in endowed operating balances were those related to scholarships, fellowships and chairs. The least impacted were medical research funds.

Dollars in Millions	**Endowed Operating Balances**			
Endowment Purpose	As of 6/30/2008	As of 6/30/2010	$ Change	% Change
Scholarships	$20.3	$17.5	($2.8)	-14%
Felloswhips	$11.1	$9.9	($1.2)	-11%
Chairs	$17.8	$17.3	($0.5)	-3%

The schools and colleges showing the largest declines in endowed operating balances are summarized below:

	Market Value		**Operating Budget Balances**			**Coverage Ratios ***		
School or College	**Total School or College Endowments $**	**#**	**As of 6/30/2008**	**As of 6/30/2010**	**% Change**	**As of 6/30/2008**	**As of 6/30/2010**	**% Change**
Information School	$3.1 mn	26	$ 313,571	$ 187,490	**-40%**	2.0	1.7	**-17%**
Undergraduate Education	$27.0 mn	24	559,572	403,894	**-28%**	0.4	0.4	**2%**
Forest Resources	$22.9 mn	85	1,495,928	1,102,234	**-26%**	1.3	1.4	**5%**
Evans School of Public Affairs	$15.2 mn	24	460,257	365,384	**-21%**	0.6	0.7	**12%**
Nursing	$21.7 mn	94	830,311	799,359	**-4%**	0.8	1.0	**33%**

** Coverage ratios are based on the current long-term spending policy.*

What is the Impact of Spending Cuts on Student Support?

Example	Endowment Market Value (Dollars in Millions)			Endowment Operating Acct (Dollars in Thousands)			Number of Student Awards		
	As of 6/30/2008	As of 6/30/2010	▲	As of 6/30/2008	As of 6/30/2010	▲	Before cut	After cut	▲
Chemical Engineering Scholarships	$2.4	$2.2	-11%	$70.6	$23.3	-67%	30	11	-63%
	The combination of rapidly escalating tuition plus declining revenues from endowments means our ability to support students has dropped precipitously.								
Evans School Fellowships	$3.0	$2.5	-16%	$132.4	$121.2	-8%	17-18	8-9	-50%
	The cut in distributions hampered our ability to raise new funds. It's difficult to meet donor expectations, primarily in financial aid, recruitment and enrichment.								
Foster Business Scholarships	$16.9	$18.6	10%	$852.0	$796.9	-6%	402	273	-32%
	Awards for MBA students dropped from $4K-$24K in FY09 to $3K-$18K in FY10 Before the decrease in distrbutions the Business School made the decision to grant larger more meaningful scholarships. This decision impacted the number of scholarships awarded.								
I School Scholarships	$0.5	$0.5	–	$30.7	$17.9	-42%	11	6	-45%
	Cuts would have been larger had not two donors made over $4K in current use awards. Our PhD program is one of the most competitive in the country but our student enrollment is suffering because we can't add scholarship money.								
Katherine Hoffman Fellowship in Nursing	$0.8	$0.6	-22%	$26.6	$8.5	-68%	11	3	-73%
	Our ability to award scholarships funding to students has been deeply impacted.								
Law Scholarships *(Excludes Gates term endowment)*	$13.0	$10.7	-16%	$628.3	$428.7	-32%	83	53	-36%
	The impact has been huge, mainly on the scholarship side Recruitment is hurting as well. Donors have stepped up but are angry at what some view as "bait and switch" - established endowments have not been able to fulfill their purpose at the reduced level.								
Mary Gates Endowed Scholarship	$31.9	$24.8	-22%	$392.3	$202.4	-48%	325	160	-51%
	We used to hold semi-annual competitions for research and quarterly competitions for leadership awards. Now we hold just one competion for each program. Cuts have had a negative impact on hundreds of students, as well as a devastating impact on undergraduate participation in research and leadership.								

What Level of Return is Needed to Cover Spending and Inflation?

Total Nominal Return* Required to Meet the Long Term Spending Target

Endowment Distributions	5.0%	Long Term Policy Rate
Advancement Office	0.8%	Administrative Fees
Treasury Office	0.2%	
Expected Inflation	3.0%	Consumer Price Index
Total Nominal Return Required	**9.0%**	

* Return is assumed net of investment fees (manager, consulting, custodial and legal) of approximately 50 b.p.

Required Nominal Return Matrix

Distribution Rate plus Administrative Fees

Inflation	3.0%	4.0%	5.0%	6.0%	7.0%
1.0%	4.0%	5.0%	6.0%	7.0%	8.0%
2.0%	5.0%	6.0%	7.0%	8.0%	9.0%
3.0%	6.0%	7.0%	8.0%	9.0%	10.0%
4.0%	7.0%	8.0%	9.0%	10.0%	11.0%
5.0%	8.0%	9.0%	10.0%	11.0%	12.0%
6.0%	9.0%	10.0%	11.0%	12.0%	13.0%
7.0%	10.0%	11.0%	12.0%	13.0%	14.0%
8.0%	11.0%	12.0%	13.0%	14.0%	15.0%

Long Term spending plus inflation rate estimate

Program distributions, administrative fees and inflation are critical factors in defining a sustainable level of program support.

Do Historical Market Returns Help Define a Sustainable Level of Spending?

Real Historical Returns (Inflation Adjusted)

U.S. Equity / U.S. Bond Ratio	1900–2009 (110 years)	1900–1979 (80 years)	1900–1969 (70 years)	Deflationary Period 1928–33 (6 yrs)	Inflationary Period 1968–81 (14 yrs)
0/100[1]	2.4	1.1	1.5	9.7	(3.8)
10/90	3.0	1.8	2.2	9.3	(3.5)
20/80	3.5	2.4	2.9	8.8	(3.2)
30/70	4.0	2.9	3.5	8.2	(2.9)
40/60	4.4	3.5	4.1	7.5	(2.6)
50/50	4.8	3.9	4.7	6.6	(2.4)
55/45	5.0	4.2	4.9	6.2	(2.3)
60/40	5.2	4.4	5.2	5.7	(2.2)
65/35	5.3	4.6	5.4	5.2	(2.1)
70/30	5.5	4.8	5.7	4.6	(2.0)
80/20	5.8	5.2	6.1	3.4	(1.8)
90/10	6.0	5.5	6.5	2.1	(1.6)
100/0[2]	6.2	5.8	6.9	0.7	(1.5)
Inflation	3.0	2.8	2.2	(4.4)	7.0

[1] Bonds only [1]2Equities only

Sources: Citigroup Global Markets, Common-Stock Indexes (Cowles Commission), Federal Reserve, Global Financial Data, Inc., Standard & Poor's, and U.S. Department of Labor - Bureau of Labor Statistics

A good endowment spending policy maintains the purchasing power of endowment assets over time. Historically, a 70% allocation to equity was sufficient to support an inflation adjusted spending level of 5%. Higher spending was possible only through a higher allocation to equities.

What is the Near to Mid-term Consensus View on Capital Markets' Returns?

Asset Class / Fund	Three to Five Year Capital Market Forecasts			Historical Returns *
	UW	Investment Managers & Banks	Investment Consultants	
Emerging Markets Equity	11%	10%	9%	14%
Developed Markets Equity	9%	9%	8%	10%
Real Assets	8%	7%	7%	8%
Opportunistic / Credit	7%	7%	7%	11%
Capital Appreciation Fund	**6.4%**	**6.0%**	**5.6%**	**7.3%**
Absolute Return	7%	6%	6%	11%
Fixed Income	3%	3%	4%	6%
Capital Preservation Fund	**1.5%**	**1.4%**	**1.5%**	**2.5%**
TOTAL CEF RETURN	**7.9%**	**7.4%**	**7.2%**	**9.8%**

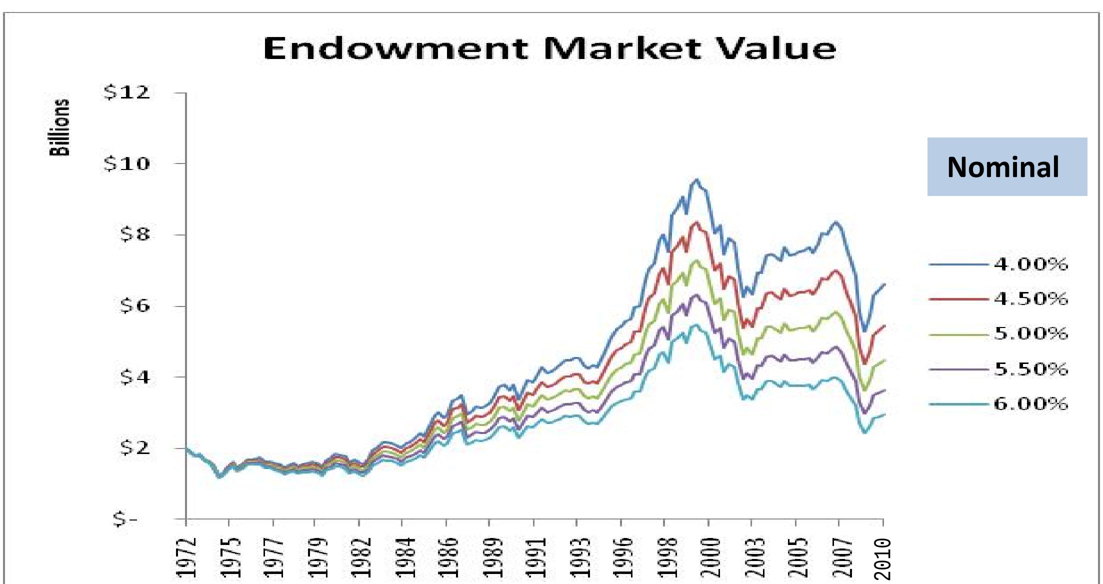
* *Historical returns represent the longest time series available for each asset class. Composite returns are calculated using the 2010 Board-approved CEF asset allocation.*

Most market experts anticipate a lower return environment over the next three to five years as compared with historical averages.

How Does the Spending Rate Impact Market Values?

Historical simulation : 1973 to current
Beginning market value: $2 billion
Spending policy: Spending rate * 5 Year average MV
Investment: 70% S&P500 and 30% Government Bond

5 Year Averaging Period	Spending Rate 4.0%	4.5%	5.0%	5.5%	6.0%
Ending Market Value	$6.6 bn	$5.4 bn	$4.5 bn	$3.6 bn	$3.0 bn
% Change in Market Value from Beginning Value of $2 bn	230%	170%	125%	80%	50%



How Does the Spending Rate Impact Payouts?

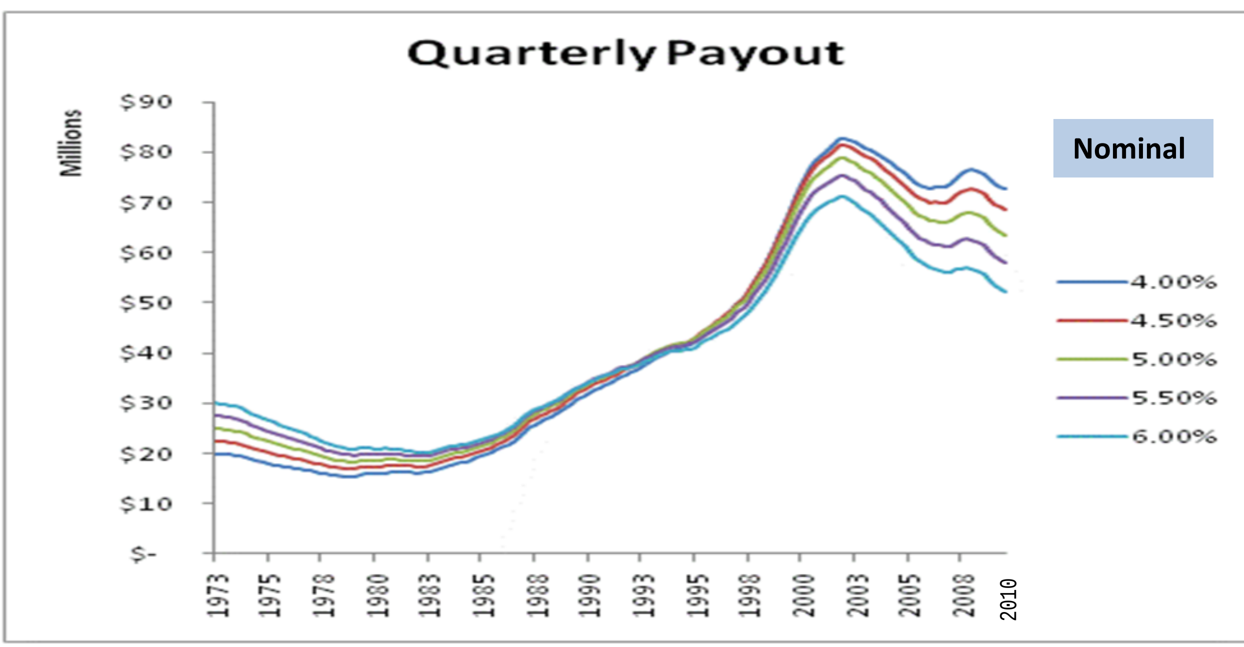
Historical simulation : 1973 to current

Beginning market value: $2 billion

Spending policy: Spending rate * 5 Year average MV

Investment: 70% S&P500 and 30% Government Bond

5 Year Averaging Period	Spending Rate 4.0%	4.5%	5.0%	5.5%	6.0%
1st Year Payout	$80 mn	$90 mn	$100 mn	$110 mn	$120 mn
Ending Annual Payout	$290 mn	$274 mn	$254 mn	$232 mn	$209 mn
% Change in Payout from 1st Year	263%	204%	154%	111%	74%



Between 20 and 30 years in most spending simulations, the "crossover" occurs where the highest payout rate provides the lowest actual dollar program distribution going forward.

How Does the Spending Level Impact the Probability of Future Impairment of the CEF?

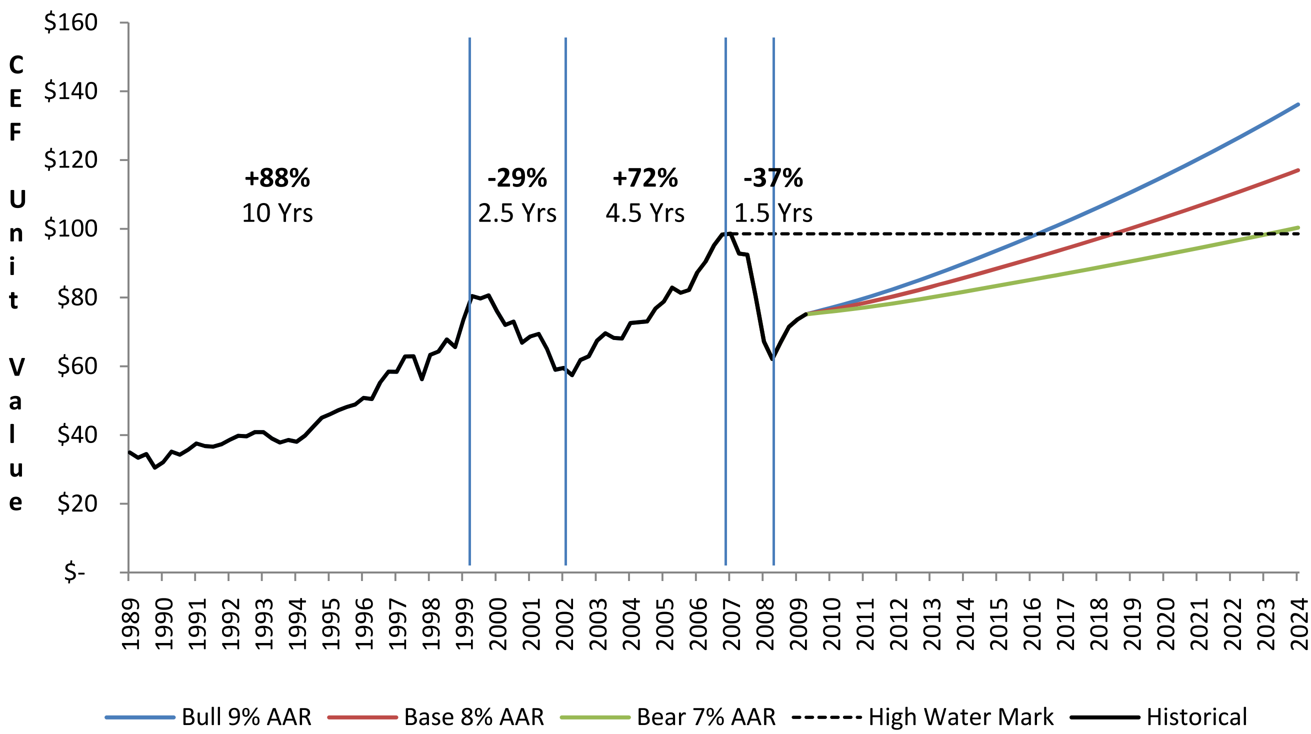
The spending level includes distributions to endowed programs and administrative fees

Spending Level	Impairment Risk
6.5%	64%
6.0%	53%
5.5%	41%
5.0%	28%
4.5%	19%
4.0%	11%
3.5%	7%
3.0%	3%

Impairment risk is the probability of losing half of the purchasing power of the endowment through capital depreciation over a 50-year horizon

Through its spending and asset allocation policies, an endowed institution balances the competing demands of current and future generations.

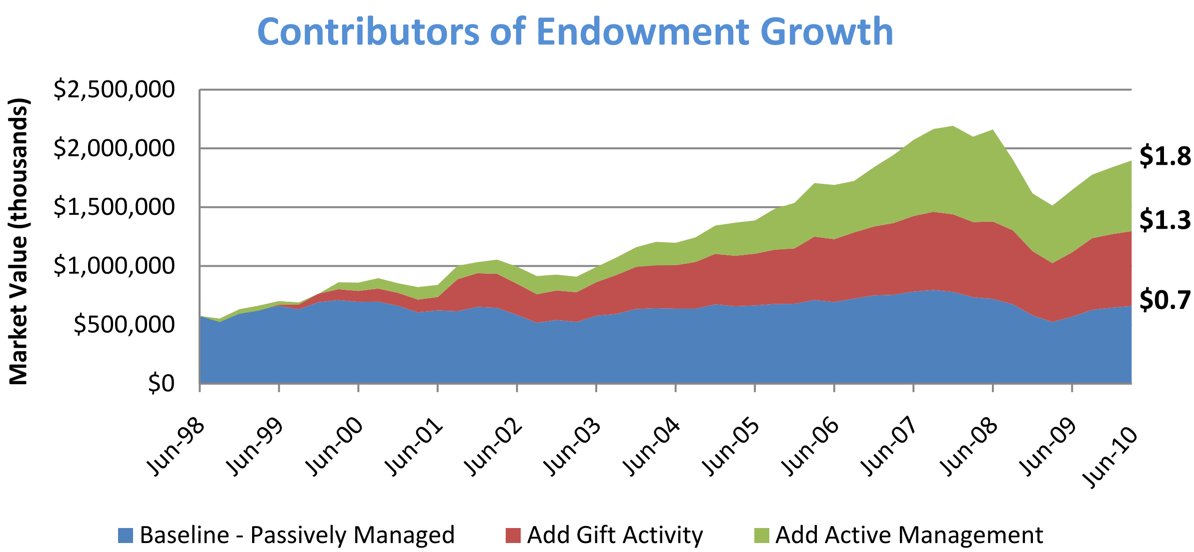
How long will it take for the CEF unit value to reach the 2007 peak valuation?



Through June 2010, the CEF per unit value recovered nearly a fifth of its decline from the 2007 peak. (The unit value does not change when gifts are added.) As the chart shows, if annual returns are 8% and the recommended total spend of 5% is approved, it will take an additional eight years to return to the 2007 peak market value per unit.

The benefits of lower spending levels are best seen over long time horizons – 25 to 50 year periods.

How have Gift Activity and Active Investment Management Contributed to Endowment Growth?



- **Blue Area Assumptions (Baseline):**
  - CEF passively invested 70% S&P 500 and 30% U.S. Government bonds
  - 25% of actual gift activity
  - No administrative fees to advancement or investments
  - $0.7 bn CEF ending market value

- **Red Area Assumptions (Add back Gift Activity):**
  - CEF passively invested 70% S&P 500 and 30% U.S. Government bonds
  - 100% of actual gift activity – invested passively
  - 80 bp administrative fee to advancement
  - $1.3 bn CEF ending market value

- **Green Area Assumptions (Add back Active Management):**
  - CEF actively managed with actual results shown
  - 100% of actual gift activity
  - 80 bp administrative fee to advancement & 20 bp administrative fee to investments
  - $1.8 bn CEF ending market value

Successful fundraising efforts coupled with an active approach to investment management led to significant growth in the CEF over the past 12 years.

What Options Were Considered in Developing the Recommendation?

SPENDING POLICY / ATTRIBUTES	(1) CURRENT LONG-TERM POLICY 6% of a 3 Yr moving average	(2) *Add Collar* 6% of a 3 Yr moving average / Change over prior yr capped at +/- 5%	(3) *Reduce Rate* 5% of a 3Yr moving average	(4) *Reduce Rate, Lengthen Averaging Period, Add Collar* 5% of a 5 Yr moving average / Change over prior yr capped at +/- 5%	(5) *Reduce Rate, Lengthen Averaging Period* 5% of a 5 Yr moving average
Intergenerational Equity *Programs supported today will be supported at the same level in the future.*	5	3	3	5	1
Predictability *Year-to-year variability in programs support is minimized.*	3	1	3	1	3
Sustainable Spending Level *Investment performance can support the spending level + keep pace with inflation.*	5	3	3	3	3
Easy to Understand *Can be easily understood by advancement staff and explained to donors*	1	5	1	5	1
Score	**14** *Overspend*	**12** *Acceptable*	**10** *Acceptable*	**14** *Underspend*	**8** *Recommended*

CONCLUSIONS:

- Spending has a much lesser impact on market values than returns.
- Over the very long term spending policies with the same spending rate, will result in very similar market values – no matter the smoothing mechanism.
- The only way to positively affect long term market value via spending policy is to lower the spending rate.
- Policy (5) is recommended because it strikes the best balance in achieving the first three goals without being too difficult to understand.

How Will the Changes be Implemented?

When will the interim policy be lifted?

- ❑ Effective the quarter in which the Board decision on CEF spending is made

What impact will the change have on Campus?

- ❑ Effect on campus is significant – especially programs dependent on one or a few large endowments.
- ❑ Lower rate and longer averaging period result in spending policy that can be sustained in volatile markets.

How will the move from the interim policy be implemented?

- ❑ Averaging will be incremental.
- ❑ During the transition to a 20 quarter average, distributions will not be allowed to increase or decrease more than 5% in any one quarter, *except* in the first quarter.

How will administrative fees be handled?

- ❑ Contrary to current practice, administrative fees will be based upon a rolling average market value.
- ❑ Averaging will be incremental.
- ❑ During the 20 quarter transition, fees will also not be allowed to increase or decrease by more than 5% in any one quarter.

Appendix

What Universities Recently Changed their Endowment Spending Policies?

University	2009 Market Value (\$ in millions)	Lower Spending Rate	Lengthen Averaging Period	Add Spending Cap and/or Floor	Change From	Change To
Pennsylvania State University	\$1,226	✔	✔		5% of the 3 year average market value	4.5% of the 5 year average market value
Ohio State University	\$1,652	✔	✔	✔	**Pre FY05:** 4.5% of the 5 year average market value	4.25% of the 7 year average market value
					FY05+: 4% of the 5 year average market value.	
					Cap / Floor: 3% maximum increase. 1% maximum decrease.	FY10: One time floor limiting drop in distribution to 3%
University of Illinois Foundation	\$826	✔	✔		4.75% of the 6 year average market value	4% of the 7 year average market value
University of Michigan	\$6,001	✔			5% of a 7 year average market value with cap of 5.3% of current market value	4.5% of a 7 year average market value with cap of 5.3% of current market value
Northwestern University	\$5,445			✔	**Market Element** - 30% weight, 4.5% of 3 year average market value **Spending Element** -70% weight, increases last year's spending rate by the actual rate of inflation plus budget growth (1.5%).	Freeze FY10 Spending at FY09 per unit spending level.
Stanford University	\$12,619	✔		✔	Payout rate established annually by the Board of Trustees. Currently targeting a long-term average annual distribution of 5.5%	The university will decrease payout on individual endowment funds by 10% in fiscal year 2010, and plans for a further 15 % reduction in fiscal year 2011

Other universities with spending rates between 4.0% and 4.5% include:
University of Wisconsin; University of Florida; University of Pittsburg; University of Minnesota; and Purdue University.

Temporary spending change

Results of Fiscal Year 2009 NACUBO-Commonfund Endowment Study

24% of Study participants deviated from their spending policy in FY09

15% of institutions with assets over $1 billion decreased spending

Of institutions decreasing spending, the average decrease was 21%

73% of institutions with assets over $1 billion increased spending

Of institutions increasing spending, the average increase was 13.3%

Cambridge Associates will update its endowment spending survey during the fall of 2010. The FY10 NACUBO Study will be available in winter 2011.