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Chief Investment Officers

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Designing a Policy to Meet Your Long-term Mission

Endowment Spending

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During today's webinar, participants will

Learning Objectives

Explain spending methodologies

Assess the impact of spending policy on endowments

Examine the alignment of asset allocation and spending policy

Hirtle, Callaghan & Co.

Presenters

John Griffith

Director and
Endowment Specialist

Catherine Lee Clarke

Investment Officer

Long-Term Partner with Independent Schools

HIRTLE CALLAGHAN

- Leading investment office for nonprofits and families
- National firm with offices in Texas, California, Philadelphia, Chicago, Cleveland, Denver, Pittsburgh
- 30+ years of experience – Since 1988
- Independent, employee-owned firm
- Conflict-free and client-aligned
- Over 200 client relationships
- Manage approximately $17 billion
- 90+ professionals
- 95% client retention rate

Armanino & Ensworth School

Presenters

Bryan Vencill

Partner

Armanino

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Senior Manager

Armanino

Whitney L. Johnson

Director of Finance and Operations

Ensworth School

Firm Overview

ABOUT US

Purpose

To be the most innovative and entrepreneurial firm that makes a positive impact on the lives and our clients, people and our communities.

Snapshot

1500+ Employees

Team Members in 22 States

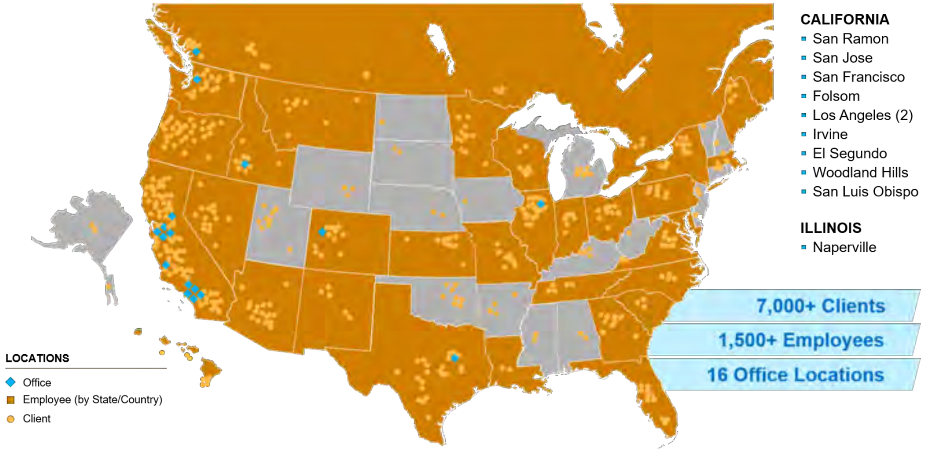
21st Largest CPA & Consulting

Largest Industries: Technology / Nonprofits

200+ Private Ed. Clients

100+ Private Ed. Audits

Locations



CALIFORNIA
- San Ramon
- San Jose
- San Francisco
- Folsom
- Los Angeles (2)
- Irvine
- El Segundo
- Woodland Hills
- San Luis Obispo

ILLINOIS
- Naperville

TEXAS
- Dallas

WASHINGTON
- Seattle

IDAHO
- Boise

COLORADO
- Denver

CANADA
- Vancouver

AFFILIATE COMPANY

AMF MEDIA GROUP

RECOGNITION & AWARDS

Why Are We Talking About Spending Policy?

Spending Policy is Critical to Your School's Long-term Success

Endowments Typically Have Three Fundamental Goals

1. Asset Preservation
2. Intergenerational Equity
3. Stable & Growing Budgetary Support

Your spending policy has a substantial impact on your ability to achieve those objectives

Spending, Return Expectation and Risk are All Linked

INFLATION

FEES

SPENDING

=

INVESTMENT RETURN OBJECTIVE

Aligning spending and asset allocation enables the endowment to keep pace with inflation

Aligning Your Spending Policy With Your Operational Model

Spending Policy Must Account for Organization's Overall Health

- Financial Condition
- Endowment Dependency

Financial Condition

Spending Policy Considerations

Schools in a Strong Financial Position

The stronger your financial condition, the lower your spending rate should be

Benefits of growing the endowment outweigh the upside of short-term spending

Although it may be tempting to spend more in good times, the prudent approach is to maintain a lower spending level - preserving the ability to spend more if the financial condition changes

Schools in a Weak Financial Position

Curbing short-term spending may be more difficult

If spending less is not an option, the asset allocation should be more growth-oriented, aiming for higher returns to offset spending

Trustees must be willing to make trade-offs to ensure the long-term sustainability of their endowment and their institution

Endowment Dependency

Spending Policy Considerations

Low Endowment Dependency

Better position to prioritize long-term endowment growth

Should maintain the lowest spending rate that the institution can withstand

High Endowment Dependency

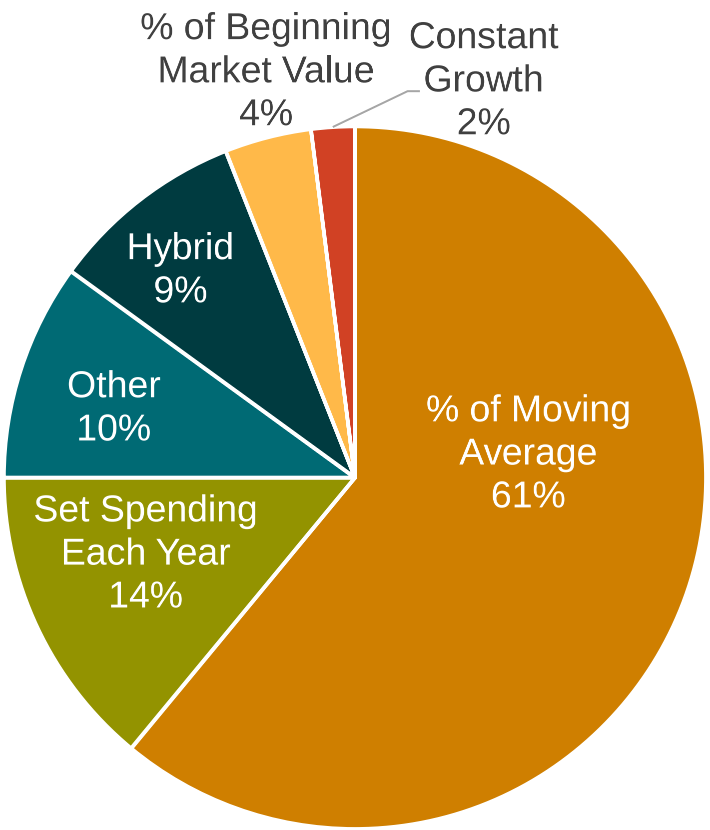
With less ability to reduce spending, focus should be on asset allocation

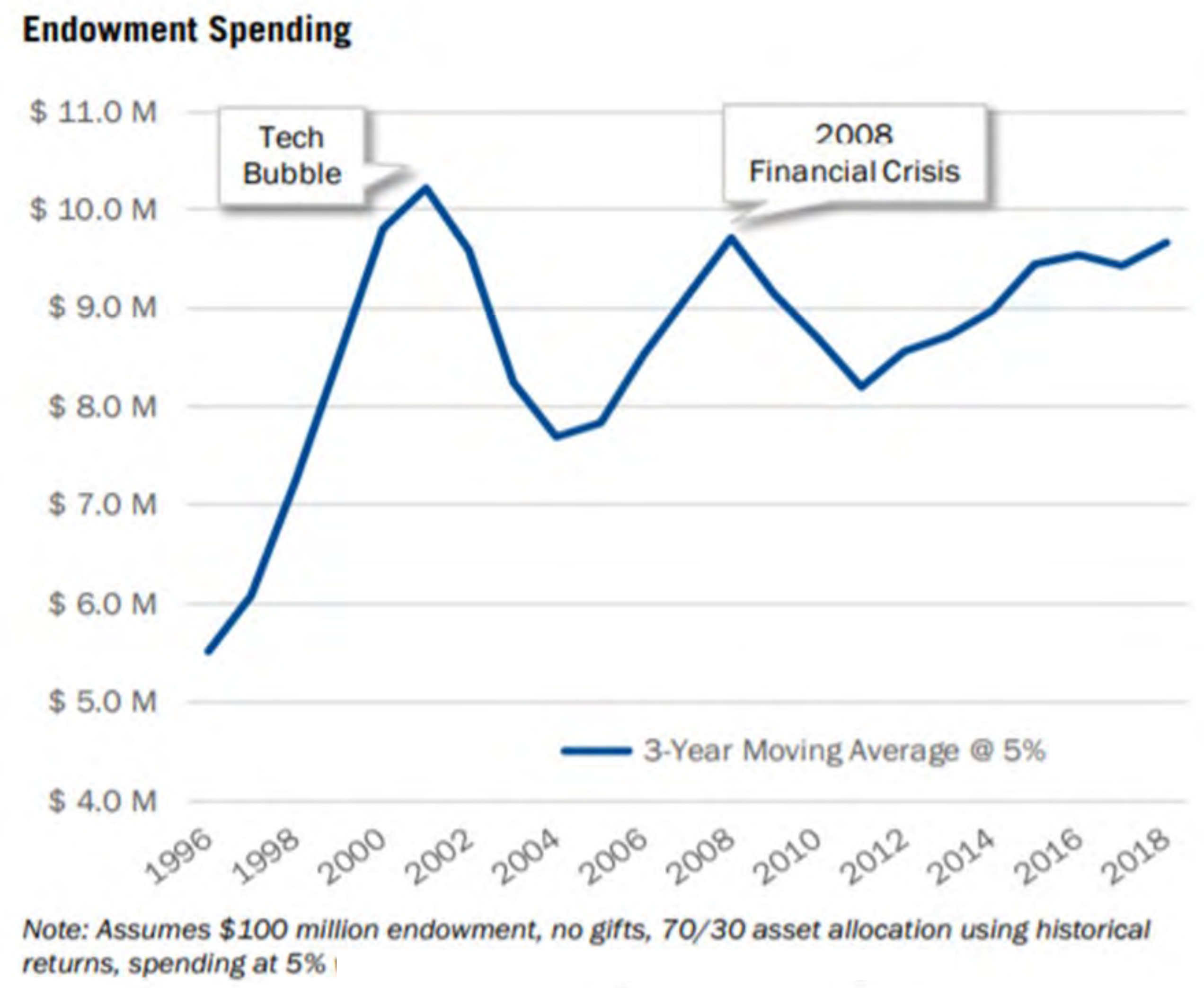
A conservative asset allocation is actually riskier

The primary concern should be failure to achieve the organization's mission if the endowment's purchasing power is eroded over time

Does Your School Have the Right Spending Policy in Place?

Most Schools Employ the Moving Average Spending Method





But the Moving Average Spending Policy Has Significant Flaws

1. Does not protect schools from market volatility which leads to excessive spending volatility.
2. Fails to provided revenue diversification. During a market crisis, net tuition, gifts and endowment spending all decline together.

What Spending Policy is Right for Your School?

Spending policy determines the annual flow of funds from the endowment to the operating budget

MOVING AVERAGE

CONSTANT GROWTH

HYBRID

% OF MARKET VALUE

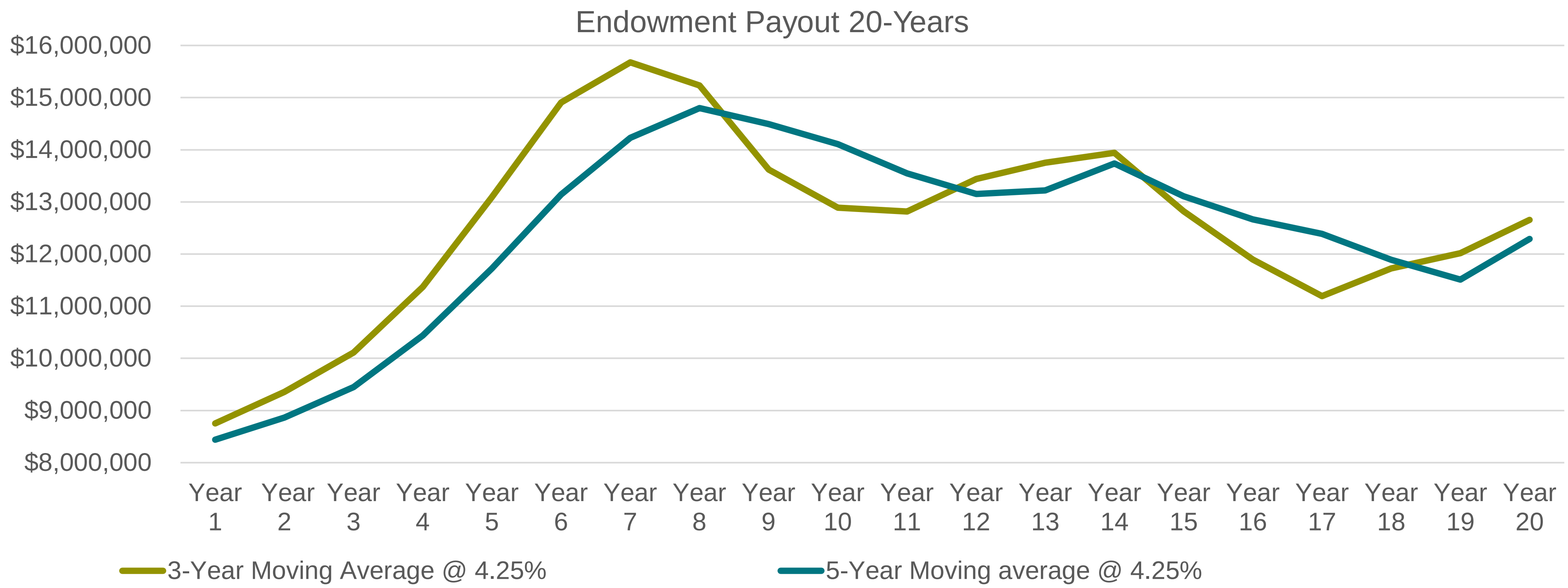
SET POLICY EACH YEAR

OTHER

Different Spending Methods Explained

	3-Year Moving Average *(Most Popular Method)*	5-Year Moving Average
How it Works	Spending rate using a 3-year (12-quarter) moving average	Spending rate using a 5-year (20-quarter) moving average
Advantages	▪ Smooths spending to ease market highs and lows ▪ Simple to implement and explain ▪ Familiar	▪ More closely aligns spending policy time horizon with investments ▪ Lowers volatility
Disadvantages	▪ Spending is still highly correlated to market value fluctuations	▪ Long tail of reduced spending

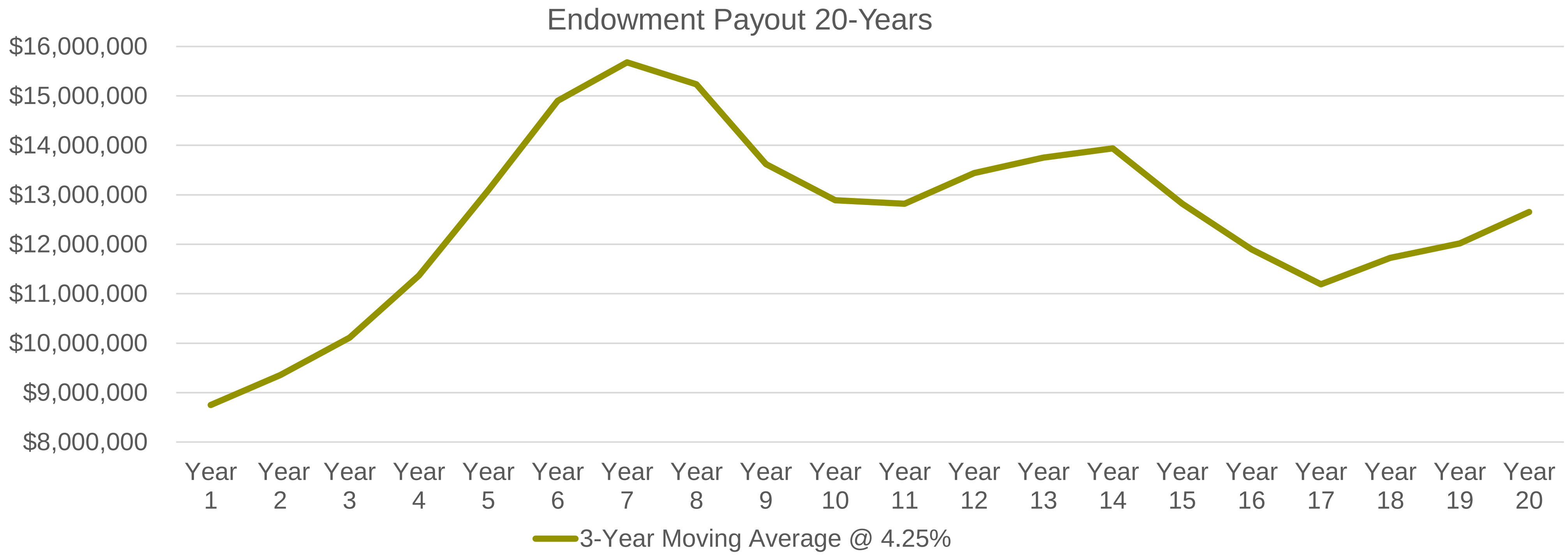
5-Year Moving Average Approach Modestly Reduces Spending Volatility



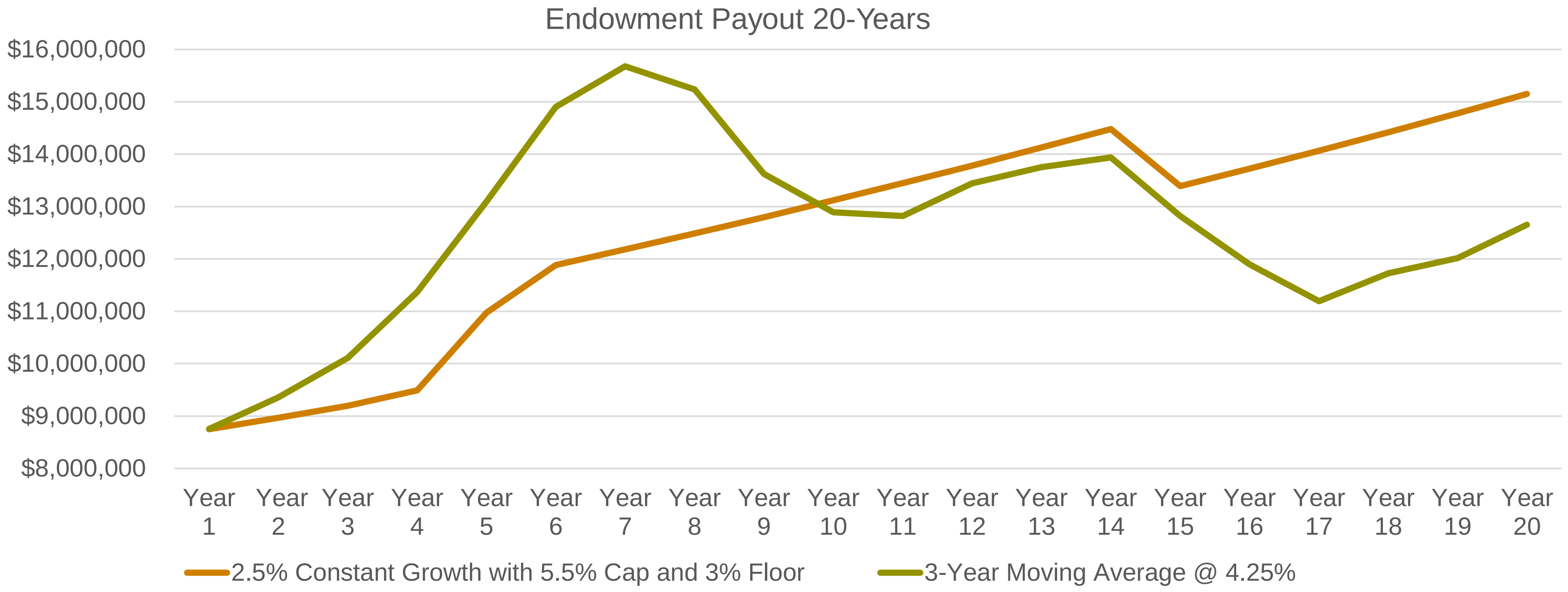
Different Spending Methods Explained

	Constant Growth	Hybrid (Yale Model)
How it Works	Prior Spending x (1 + growth rate or CPI) + (Prior year gifts x spending rate)	(70-80%) Constant Growth + (20-30%) Moving Average
Advantages	▪ Smooths spending ▪ Spending is more predictable ▪ Flexibility in setting growth rate ▪ Fits with donor intent ▪ Provides protection when markets decline	▪ Enables stable distributions and maintains purchasing power ▪ Spending rules can be customized to fit unique needs
Disadvantages	▪ Not as responsive to changes in endowment market value ▪ Spending can be higher during prolonged bear markets, and moderated during strong markets	▪ Finding and maintaining the right combination of spending rules requires judgment ▪ More complex than other methods

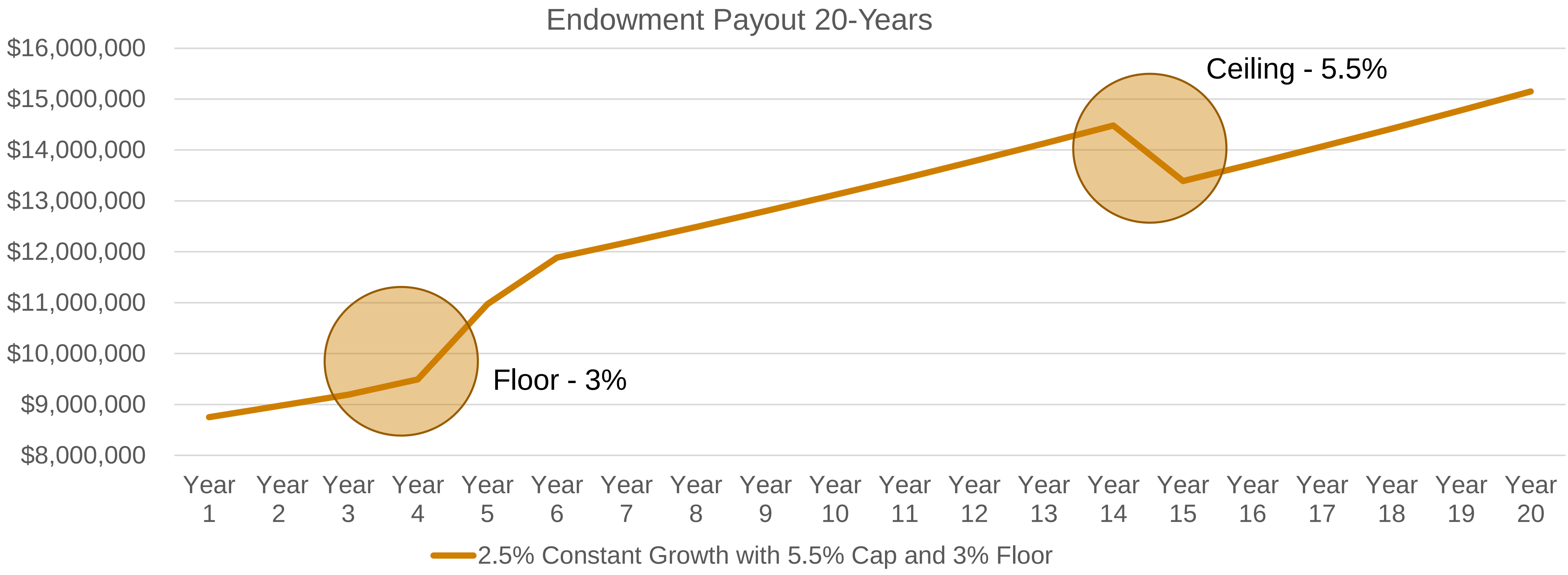
Spending with the Moving Average Approach is Volatile



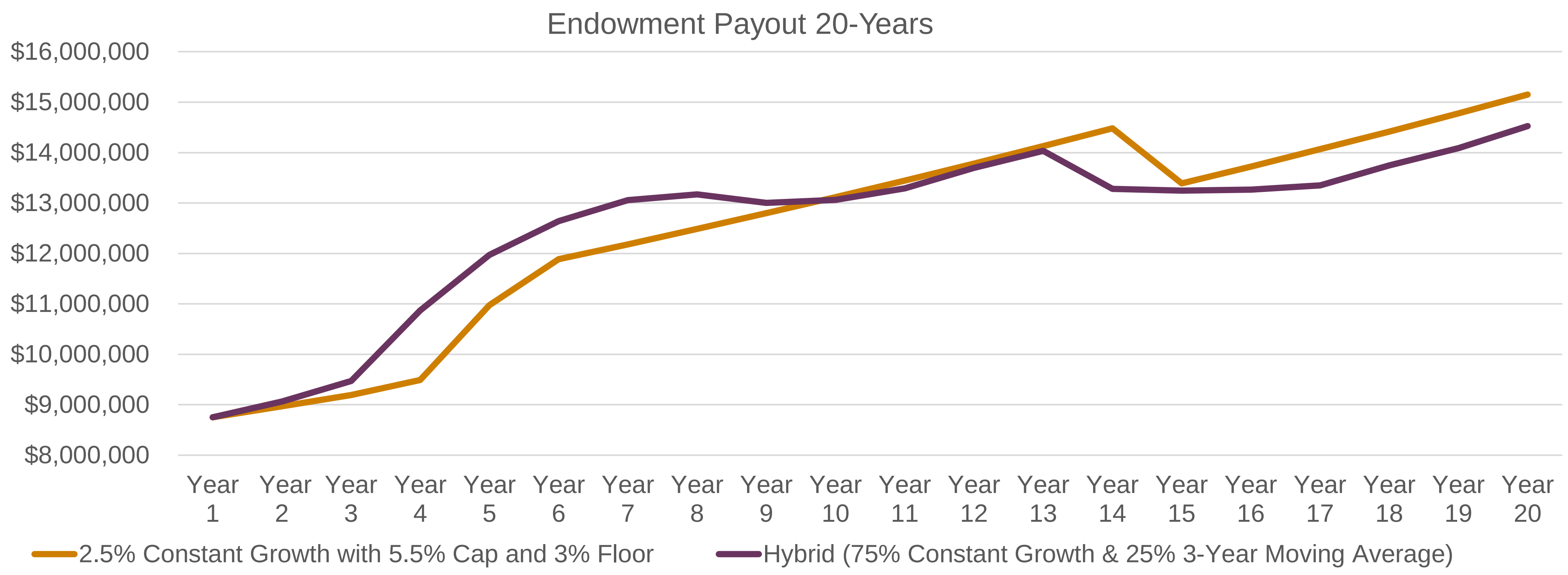
Constant Growth Method Smooths Spending to Ease Market Highs and Lows



Floors & Ceilings Prevent Disconnect Between Endowment Spending and Market Value



Constant Growth and Hybrid Models Both Produce More Predictable Spending



Constant Growth is the Best Fit For Most Endowments

- Creates more control over spending
- Makes spending more predictable, facilitating budgeting and financial planning
- Separates the growth in endowment spending from market volatility
- Can add floor and celling to keep spending % within a corridor
- Acts as a revenue diversifier
  - Lower spending during boom times
  - Higher spending during bad times

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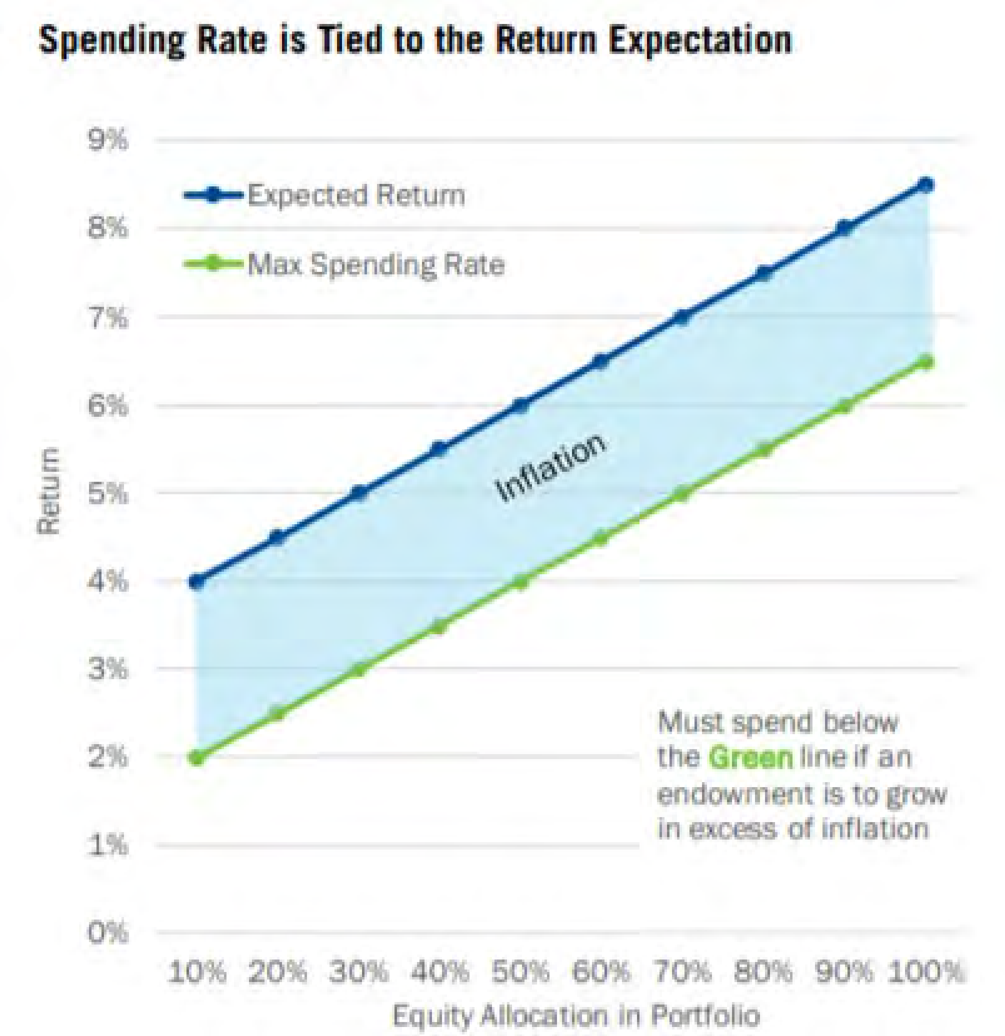
Aligning Your Asset Allocation With Your Spending Policy

Spending, Return Expectation and Risk are All Linked

INFLATION		
FEES	=	INVESTMENT RETURN OBJECTIVE
SPENDING		

Aligning spending and asset allocation enables the endowment to keep pace with inflation

Spending Rates Impact an Endowment's Required Return



* Equity allocation includes private equity and alternative assets

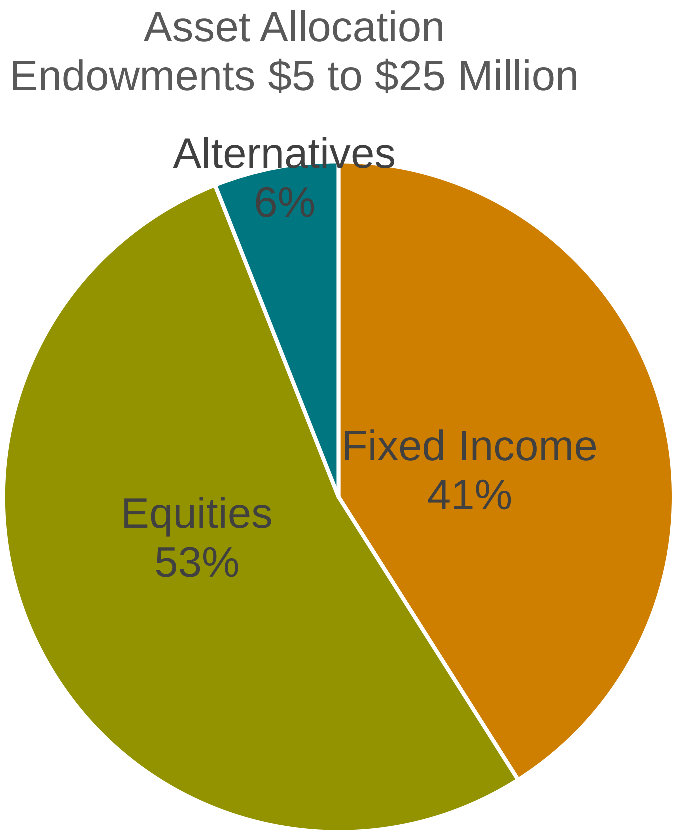
The Endowment’s Primary Goal is to Maintain Purchasing Power

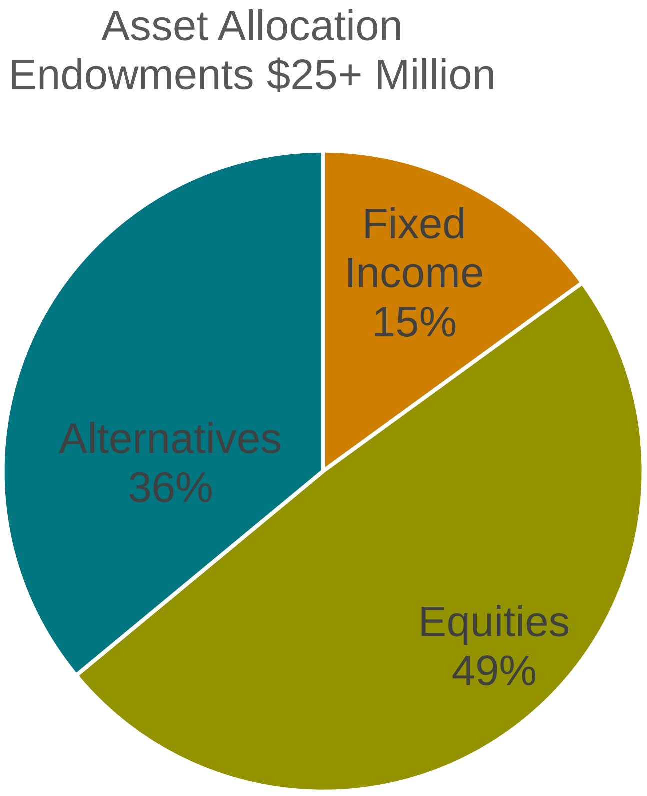
Probability of Maintaining Purchasing Power [1]

	7% Return			8% Return		
Spend Rate	10 Years	15 Years	20 Years	10 Years	15 Years	20 Years
3.5%	62%	64%	66%	66%	69%	72%
4.0%	56%	57%	58%	61%	64%	66%
4.5%	50%	49%	49%	56%	58%	59%
5.0%	43%	42%	41%	52%	52%	52%
5.5%	38%	35%	33%	47%	46%	45%
6.0%	32%	28%	25%	42%	40%	39%

Tradeoff of current spending vs endowment growth for future generations

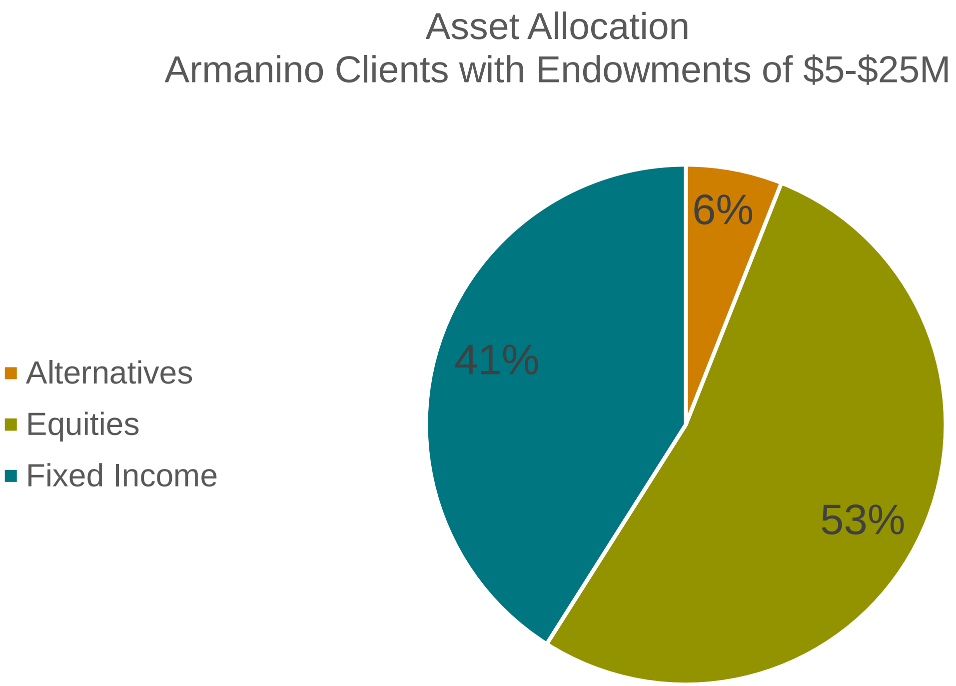
Endowment Size Tends to Influence Asset Allocation





Asset Allocation

Keeping Pace with Inflation



Portfolio Return

	Asset Allocation	Estimated Return	Weighted Return
Fixed Income	41%	2.5%	1.0%
Equities	53%	7.0%	3.7%
Alternatives	6%	4.0%	0.2%
Estimated Return			5.0%

Required Return

Spending	4.0%
Inflation	2.0%
total	6.0%

Lower Spending Rates Can Generate Higher Spending Dollars

Over 20 years the endowment spending will be higher using a 5% rate than a 5.25% rate because of compounding returns.

Investment Objective

1. Return objective – Two options
   I. Preserve the purchasing power of the endowment in perpetuity
   II. Grow the purchasing power of the endowment at a rate in excess of inflation
2. Provide a reasonably predictable and stable stream of annual cash distributions to assist in funding the School's operating budget
3. Attain such return objectives without the assumption of inappropriate risk

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Thank You

Continue The Conversation

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