

Endowment Spending – A Practical Explanation

- Endowments at NC State are pooled within the NC State Investment Fund, Inc. There are approximately 2,600 individual endowments invested in this pool.
- Earnings (interest, dividends, & realized/unrealized gains & losses) are allocated to individual endowments based on pro rata share of units owned (similar to a mutual fund). Allocations occur quarterly.
- Spending budgets are calculated annually. The spending rate calculation computes 4% of the average market value for all 'units' owned by the endowment pool over a 20 quarter period, and multiplies this spending rate times the number of units each individual endowment owns.
- An 'averaging' methodology helps smooth out year-to-year fluctuations due to market volatility. This is especially important for scholarship endowments, which often have multi-year commitments.

Real World Example:

In the 4th quarter of FY13 a new endowment was established at \$25,000. The market value of this endowment for each fiscal year-end has been:

FY14	\$29,049
FY15	\$30,489
FY16	\$28,850
FY17	\$31,014
FY18	\$33,215

The number of units owned by this endowment at the end of FY18 (June 30, 2018) was 139.86 units.

As of June 30, 2018 the 20-quarter average market value per unit for the entire investment pool was \$199.78/unit. Per the Foundation's spending policy, the calculated spending rate is 4% of \$199.78, or \$7.99 per unit. This results in a calculated spending budget amount for this specific endowment of \$1,117 (\$7.99/unit multiplied by 139.86 units).

Because of the averaging effect of the Foundation's spending policy, the calculated amount does not equal 4% of the ending market value. In this example, the calculated spending amount (\$1,117) equals 3.36% of the ending market value, which we often refer to as the 'Effective Spending Rate'. The Effective Spending Rate is the calculated spending amount, based on the Foundation's spending policy, divided by the ending market value of the period being calculated. During periods of positive investment performance the effective spending rate will be lower than 4%. Conversely, during periods of negative investment performance the effective spending rate will be higher than 4%.

It is important to note that the effective spending rate is not part of any foundation spending policy, nor is it part of the spending amount calculation process. The concept of 'effective spending rate' is just a 'quick and dirty' way to provide an estimated spending budget based on an endowment's value at a point in time. It gives us an easy way to provide a ballpark estimate of what an endowment, valued at some amount at 6/30/18, will provide in spending for FY20, which we know will be different than 4% of that ending market value. It is also important to note that when FAI refers to an 'effective spending rate' our reference is to the effective rate for the entire investment pool as a whole. The effective spending rate for an individual endowment could be slightly different depending on when it is endowed IF it is endowed within that 20 quarter period.