FAI Q&A Session #6
October 16, 2007
Visitors Center Multi-Purpose Room #153
Attendance: _18_

TOPIC: **Endowment Spending Budgets**

FAI presenters were Mike Dickerson (513-4303) and Susan Holton (515-7375).

1. **Why do we have endowment spending policies (procedures)?**
   - To establish spending rates and a computational methodology that will:
     - Provide intergenerational equity, or preservation of the endowment to serve future generations. For example, if an endowment provides a spending budget of $1,000 today, in 50 years that spending budget needs to increase at least by the amount of inflation to provide same "purchasing power".
     - Protect against inflation. The Higher Education Price Index (HEPI) measures inflation for colleges and universities, which is consistently higher than the Consumer Price Index (CPI). For the year 2007, HEPI was 3.7% as compared to CPI of 2.6%.
     - Cover fees related to investing and managing the endowment, including investment managers, custodial, and administrative.
     - Result in consistent, steady budget amounts from year-to-year, which is particularly important for scholarships and fellowships where there may be multi-year commitments.

2. **How are programmatic spending rates determined?**
   - Approved by each entity's Board of Directors
   - Reviewed on an ongoing basis by FAI
   - Reviewing projected rates of return by asset class for the next 5 to 10 years
   - Considering applicable fees, including investment managers, custodial, administrative and fund-raising
   - Incorporating projected inflation (HEPI)
   - Using a methodology that smoothes out the effect of market fluctuations

3. **What is the timeline of the spending budget computation process?**

   See Slide #9 of 17 on "Spending Budget Process" on FAI's website.
   http://www.fis.ncsu.edu/foundations_accounting/faqs/documents/HOW%20Spending%20Budgets%20FY08%20Update.pdf

   Also see narrative "Spending Budget Cycle" on FAI's website.
   http://www.fis.ncsu.edu/foundations_accounting/faqs/documents/Spending%20Budget%20Cycle%20for%20Web%20FY08.pdf

4. **If the spending rate is 4%, why doesn't my endowment spending budget equal 4% of ending market value?**

   Because of the 20-quarter averaging technique used to soften market ups and downs. The 4% spending rate is applied to the 20-quarter average market value per unit to determine a spending amount per unit. This spending amount per unit is then multiplied by the number of units each endowment owns at fiscal year end.

When explaining the 4% spending policy rate to donors, you can say that 4% times the market value APPROXIMATES the spending budget amount. But that is not how spending budgets are computed, so the actual budget amounts will differ, and typically will be slightly lower than 4%.

For specific computation methodology, refer to slides #10 through #12 on "Endowment Budgeting Process" on FAI's website.

http://www.fis.ncsu.edu/foundations_accounting/faqs/documents/HOW%20Spending%20Budgets%20FY08%20Update.pdf

5. **Why does it take so long for new endowments to start spending?**

   Refer to slides #2 through #4 on "New Endowment Spending Budgets" on FAI's website.

   http://www.fis.ncsu.edu/foundations_accounting/faqs/documents/New%20Endowment%20Spending%209-24-07.pdf

6. **What are spending reserves, and why are they important?**

   UMIFA (Uniform Management of Institutional Funds Act), which has been adopted by the State of North Carolina, does not allow spending of corpus, which is the original gift. In order to provide funds for spending adequate spending reserves must be available. Spending reserves represent prior years excess earnings and unspent spending budgets that have accumulated over time. These funds are reinvested, and help the endowment grow, and provide a "cushion" which can be used during down markets. Without this cushion, spending budgets may need to be reduced, or even eliminated.

7. **What nuances surround new endowments and affect when spending can begin?**
   - A new endowment must have adequate spending reserves before spending can begin.
   - New endowments begin to earn, or accumulate spending reserves, starting the quarter AFTER being invested in the long-term pool (NCSIF).
     - This means that a new endowment invested during the 4/1/xx-6/30/xx quarter will not have any earnings as of 6/30/xx, the computation date for spending budgets.
   - Quarter ends are critical dates for endowments, since the unitization is performed on a quarterly basis. Receiving or processing a new endowment after quarter end could affect when spending will begin.
   - Asking a donor for an additional gift to jump start spending while the endowment is accumulating spending reserves is widely practiced. This will allow spending to begin earlier, and also allow the endowment to begin accumulating spending reserves for future use.

8. **Why do other universities have higher spending rates, or different computations, than we do?**

   There could be numerous reasons why endowment spending rates at other universities are higher than at NC State. A few of those reasons are:

   (a) Underlying asset allocations in their long-term investment pool may differ from ours.
   (b) Larger endowment pools (> $1 billion) typically have lower investment manager fees (as a percentage), thus leaving more return for programmatic purposes.
   (c) Private colleges and universities typically have to fund a significant portion of their operating costs (e.g., utilities) from endowments, so they often have to spend more.
   (d) They may not be assessing internal administrative fees against their endowments, thus leaving more for programmatic purposes.
   (e) Other discretionary funds are available to "jump start" spending from new endowments or supplement higher spending rates.
   (f) They may not be covering inflation when developing their spending rate.
   (g) Their computational method may be different and a higher spending rate is quoted even though dollar amounts may be close to ours.
   (h) The spending rate quoted may be an effective rate or an average rate, including spending exceptions above the standard rate.

9. **Can exceptions to the policy be requested?**

   The spending policies are approved by each entity's Board. Currently the policies are the same for all entities managed by FAI, except for the University Endowment Fund. As part of the foundations' spending policy, exceptions can be requested and must be approved by the Dean and Treasurer. University Endowment Fund exceptions have to be taken to the board for approval. Exceptions can only be granted if adequate spending reserves exist.

10. **What is the process for requesting a spending exception?**

    After FAI notifies campus of next fiscal year's spending budgets each December, a second notification is provided listing endowments that do not qualify for a spending budget. This notification provides the mechanism for requesting an exception, if critical to a donor relationship. Exception requests should first be approved by the dean, and then be submitted through FAI for the Treasurer's approval. In the case of spending exceptions for endowments in the University Endowment Fund, the Treasurer takes the recommendation to the board for their consideration. FAI notifies the appropriate persons when an exception has been approved by the Treasurer or the University Endowment Board.