SouthCol

Prudent vs. Proactive: Crafting an Effective Spend Policy

One of the most important policies for any nonprofit institution is a detailed and realistic Spend Policy. Sometimes referred to as the distribution policy, the Spend Policy is necessary to support a wide range of organizational goals, from administrative costs to grantmaking to new facilities and programming. The effectiveness of an institution's spend policy is critical to its ability to fund its long-term mission.

Spend Policy initial considerations

- **Define your time horizon –** Many nonprofit institutions establish a spend policy around a rolling 12-quarter time horizon, with a goal of having distributions last in perpetuity.
- **Understand your return objectives –** Understanding your organization's risk and return objectives – as outlined in the Investment Policy Statement – is an important first step in establishing realistic funding expectations.
- **Define long- and short-term spending goals –** Have a detailed list of the exact costs, programs, grants, etc. that will be supported by the spend policy.
- **Consider distribution frequency and timing –** The frequency of distributions is important to define as it will impact strategic asset allocation and liquidity. Keep in mind that the return objective must be able to support the minimum required distributions.

Nonprofits often ask, *"How much do we spend today vs. invest for tomorrow?"*

Here are a few benchmarks:

- NACUBO-TIAA: The median spending rate for college and university endowments was **4.7% in 2023**.
- Commonfund: The average spending rate across various nonprofits, including private foundations and higher education, was **5.1% in 2023**.
- Council on Foundations: Community foundations had an average spending rate of **4.6% in 2023**.

Sources: NACUBO, Commonfund, Council on Foundations

Which methodology is best for your organization?

- **Define spending rules –** There are several different methods for establishing spending rules. Your investment advisor can help in determining which methodology is most appropriate for your institution's unique goals.
- **Analyze various portfolio outcomes –** The size and frequency of distributions can have a measurable impact on portfolio outcomes. It is important to analyze these variables and adjust distribution expectations, as needed.
- **Consider inflation and cost increases –** To preserve the long-term purchasing power of the spend policy, it should include a long-term inflation assumption.

How do you measure success?

- **Utilize additional resources –** While there is no "one size fits all" when it comes to spend policy, there are several organizations – UPMIFA and CEFEX – that provide general guidelines and best practices.
- **Establish yearly reviews –** The spend policy should be monitored quarterly and as needed based on changes in the market or within the institution. The spend policy should be thoroughly reviewed on an annual basis.
- **Keep your board informed –** New board or investment committee members should receive the spend policy during onboarding to ensure they understand how the investment portfolio supports the institution's work.

By incorporating these key elements, a well-crafted and disciplined Spend Policy provides an effective framework to help manage an institution's distributions in perpetuity.

For more information on Spend Policy best practices, contact james.lumberg@southcoladvisors.com.