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Spending Policy Changes: Colleges and Universities

April 2009

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C O N T E N T S

SUMMARY OF SURVEY RESPONSES

Survey

We recently surveyed 165 U.S. colleges and universities regarding their current spending policies, recent and future changes to these spending policies, and expectations for endowment withdrawals for the current and next fiscal year. The survey was designed to share information on how institutions are coping with the current economic downturn, which has intensified the challenge of balancing the competing goals of maintaining the purchasing power of the endowment and providing a maximum financial benefit to colleges and universities facing increased financial pressures. At its core, a spending policy is designed to balance the needs of both current and future generations. The challenge is finding the balance by providing continued (or growing) financial support to the institution while being mindful of preserving the endowment value in an uncertain market environment.

While the endowment represents only part of an institution's financial resources, tracking changes in spending policy and practices can provide a snapshot of how schools are tackling not only the current situation but also the long-term strategies for recovery and growth.

We received responses from 68 institutions. Although responses varied, more respondents expect to increase rather than decrease total endowment withdrawals in the current fiscal year relative to the prior fiscal year. For fiscal year 2009–10, more respondents plan to decrease withdrawals to preserve wealth in what may be a protracted, difficult environment. Institutions reflect longer-term strategic changes through a change in spending policies. Among the 68 responding institutions, six approved changes to their polices for fiscal year 2008–09 in the last six months, while 29 have approved or are considering changes for fiscal year 2009–10 or beyond. The following sections summarize our findings.

Overview of Spending Policy Changes

Of the 68 institutions responding to our survey, 32 indicated they have implemented, have approved, or are seriously considering making a change to their spending policy (Exhibits 1, 2A, and 2B).

- Changes to a spending policy can take time to implement, but some colleges and universities have implemented spending policy changes over the last six months to take effect in the current fiscal year. Six institutions reported making such policy changes, though some were planned before the steep market decline in late 2008. The most common spending changes (four of the six) related to treatment of underwater endowments. These changes are outlined in Exhibit 2A.

- Most institutions planning to make changes to their spending policies will do so for fiscal year 2009–10. Four colleges and universities have plans to modify their spending rule type in fiscal year 2009–10 or later. In addition, five have approved and eight are considering making changes to the spending rule target rate. Of the 13 institutions that have approved or are considering changing spending rule target rates, eight intend to decrease the rate, while two plan to increase the rate. The remaining three institutions are planning to make a change to the rate but have not determined the magnitude or direction of the change.

- Six institutions are considering adding or making changes to spending floors, caps, and collars. Two colleges and universities are adding a collar and one is adding a spending floor to their calculations. Three institutions will implement changes to existing policies, with one decreased cap, one increased cap, and one lowered floor (Exhibits 1 and 2B).

- Eight institutions have approved or are considering making changes to the way in which they smooth market values in market value–based spending rules. Six of these institutions seek to increase the time horizon over which the market values are smoothed (Exhibit 2B).

Not all institutions are amending the spending policy itself. Some are opting to temporarily override the policy and either increase or decrease the funds being withdrawn from the endowment (Exhibit 3).

- For fiscal year 2008–09, four of 68 colleges and universities expect to spend more than the amount calculated by the stated policy, and six plan to spend less.

- For fiscal year 2009–10, 19 of 67 colleges and universities responding to this question expect to spend less than their spending policy dictates, while three will most likely need to spend more.

Anticipated Total Endowment Withdrawal for 2008–09

- Survey respondents provided the anticipated total endowment withdrawal for fiscal year 2008–09 as a percentage of beginning market value. Of the 67 colleges and universities that provided data, 31 expected total withdrawals of between 4.0% and 4.9% (Exhibit 4).

- About one-third of the group (21 of 66) that provided data did not expect to change the withdrawal amount in fiscal year 2008–09. Thirty-two anticipate increasing the withdrawal amount, and 13 will most likely draw less (Exhibit 5).

- In fiscal year 2009–10, 34 colleges and universities expect to reduce their withdrawal from the previous year, 22 will most likely increase it, and ten plan to make no change (Exhibit 5).

Overview of Spending Rules

- Market value–based spending rules, which base spending on a prespecified percentage of endowment market value or a trailing average market value, continue to be the most common, used by 51 of the 68 reporting colleges and universities (Exhibit 6A).

- The most common smoothing period, used by 37 of the 51 colleges and universities with market value–based spending rules, is a three-year time horizon. About two-thirds of this group (22 of 37) are calculating their moving averages based on quarterly data (Exhibit 7).

- An increasing number of market value–based policies (seven of 51) include a market value–based range within which institutions have discretion to set endowment spending levels.

- Thirteen reporting institutions employed collars to maintain spending rates within a band. Additionally, one institution defined only a floor for spending, and six incorporated only a cap (Exhibit 8A and 8B).

- As might be expected, collars were most commonly used among institutions with constant growth rules to provide a link between spending and endowment market values. Of the ten institutions reporting use of a constant growth spending rule, nine reported using a collar. Only three of the 51 institutions using a market value–based spending rule reported employing a collar (Exhibit 8A).

- The most common range for collars, or collar width, was 1 percentage point. Most often (in six of the 13 instances reported) the range was around a midpoint of 5.0% (Exhibit 8B).

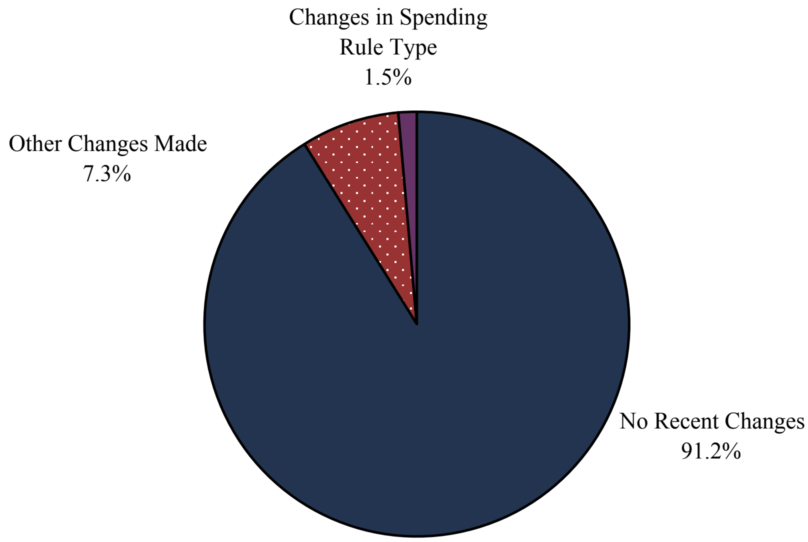
EXHIBITS

Exhibit 1

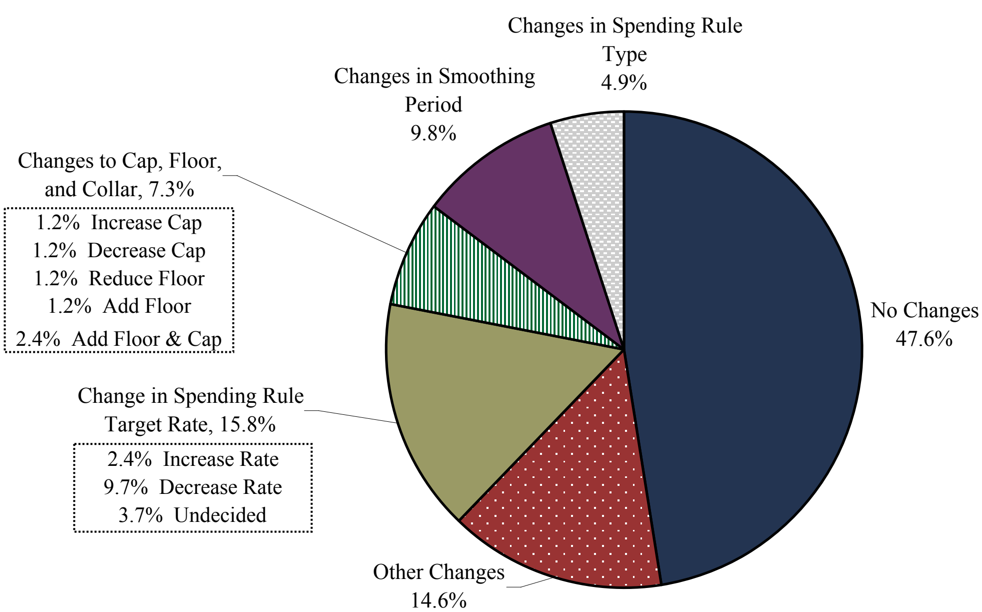
CHANGES IN SPENDING POLICIES

By Type

Changes Governing Spending in 2008–09
Implemented in the Last Six Months



Changes Governing Spending in 2009–10 and Beyond
Approved for Implementation or Under Consideration



Notes: In a few instances, institutions had changes in multiple categories. In total, there were six changes made at six institutions for 2008–09. Similarly, the bottom chart reflects the 43 changes approved for implementation or under consideration at 29 institutions for 2009–10.

Exhibit 2A

CHANGES GOVERNING SPENDING IN 2008–09
IMPLEMENTED IN THE LAST SIX MONTHS

Changes to Spending Rule

Code	New	Previous
20	Hybrid policy	Constant growth policy

Other Types of Changes

Code	Description of Change
16	With the new UPMIFA law, changed the payout rate from 2% to 4% for those endowments underwater (if this is consistent with the agreement).
31	4% spending allowances that bring gift fair market value underwater can be granted but only with approval from the Investment Committee. Also, spending allowances in excess of 4% can now be approved on an exceptional basis.
46	Override spending rule to focus on actual dollar amount necessary for the budget, as opposed to the amount calculated from spending rule.
53	Suspend spending on underwater accounts.
58	Investment Committee has considered UPMIFA and decided to spend only ordinary income on underwater funds.

Notes: Some institutions have made multiple changes and are listed in each relevant category. Institutions in blue are publicly funded.

Exhibit 2B

CHANGES GOVERNING SPENDING IN 2009–10 AND BEYOND APPROVED FOR IMPLEMENTATION OR UNDER CONSIDERATION

Changes to Spending Rule

Code	Current	Proposed Change
16	Prespecified % of moving average MV	Constant growth policy beginning 2009–10
30	Prespecified % of moving average MV	Constant growth policy beginning 2010–11
44	Prespecified % of moving average MV	To be determined
64	Prespecified % of moving average MV	Hybrid policy (Long-range possibility)

Changes to Spending Rule Target Rate for 2009–10

Code	Current	Approved for 2009–10
15	Spending Rule Target Rate of 5.0%	Decrease Spending Rule Target Rate to 4.5%
30	Spending Rule Target Rate of 5.0%	Decrease Spending Rule Target Rate to 4.0%
40	Spending Rule Target Rate of 4.75%	Decrease Spending Rule Target Rate to 4.00%
55	Spending Rule Target Rate of 5.0%	Decrease Spending Rule Target Rate to 4.0%
64	Spending Rule Target Rate of 5.0%	Decrease Spending Rule Target Rate to 4.86%

Changes to Spending Rule Target Rate Under Consideration

Code	Current	Proposed Change
8	Spending Rule Target Rate of 5.75%	Decrease to Spending Rule Target Rate of 5.00%
13	Spending Rule Target Rate of 4.8%	Decrease to Spending Rule Target Rate of 4.5%
16	Spending Rule Target Rate of 4.0%	To be determined
27	Spending Rule Target Rate of 5.0%	To be determined
42	Spending Rule Target Rate of 4.5%	Increase to Spending Rule Target Rate of 5.0%
44	Spending Rule Target Rate between 4.5% and 5.5%	To be determined
49	Spending Rule Target Rate of 4.0%	Increase to Spending Rule Target Rate of 4.5%
68	Spending Rule Target Rate of 5.0%	Decrease to Spending Rule Target Rate of 4.0%

Spending Rule Mechanics: Changes to Smoothing Periods for 2009–10

Code	Current	Approved for 2009–10
19	12-Q moving average MV	20-Q moving average MV (transitioning to a 16-Q average in 2009–10 and then adding one to the calculation period per quarter until it reaches 20-Q)
40	24-Q moving average MV	28-Q moving average MV
58	3-Y moving average MV	20-Q moving average MV

Spending Rule Mechanics: Smoothing Period Changes Under Consideration

Code	Current	Proposed Change
16	12-M moving average MV	12-Q moving average MV
29	3-Y annual moving average MV	12-Q moving average MV
30	12-Q moving average MV	8-Q moving average MV (or less)
45	12-Q moving average MV	24-Q moving average MV
68	12-Q moving average MV	20-Q moving average MV in FY2014 (or earlier)

Notes: Some institutions have made multiple changes and are listed in each relevant category. Institutions in blue are publicly funded.

Exhibit 2B (continued)

CHANGES GOVERNING SPENDING IN 2009–10 AND BEYOND APPROVED FOR IMPLEMENTATION OR UNDER CONSIDERATION

Changes to Spending Rule Mechanics: Caps, Floors and Collars

Code	Current	Proposed Change
6	Collar: 4.5-5.5% of a 12-Q moving average MV	Possible reduction to floor
37	No floor or cap in place	Considering floor at some percentage of a moving average
40	No floor or cap in place	Considering adding cap/floor feature eventually (not FY2010)
43	Cap: 10% increase over prior year	Will likely cap growth at 0% until 3-Y average statistic fully reflects current losses.
45	Collar: 4.5-6.0% of a 12-Q moving average MV	Possibly allow increase in ceiling cap up to 7% upon board approval.
59	No floor or cap in place	We intend to formally incorporate a cap and a floor. Probably 4.0-6.0% of BMV.

Other Types of Changes

Code	Implementation in 2009–10
51	Reduced spending by 10% on a one-time basis for FY2009–10. We used to increase each year for inflation around a range and have lowered the range along with no inflation based increase for FY2009–10.
64	In FY2010 the intent is to hold endowment spending flat (in terms of dollars per share) with FY2009, in anticipation of an even greater decrease in the endowment payout in FY2011 (in terms of dollars per share) at the targeted rate of 5%.

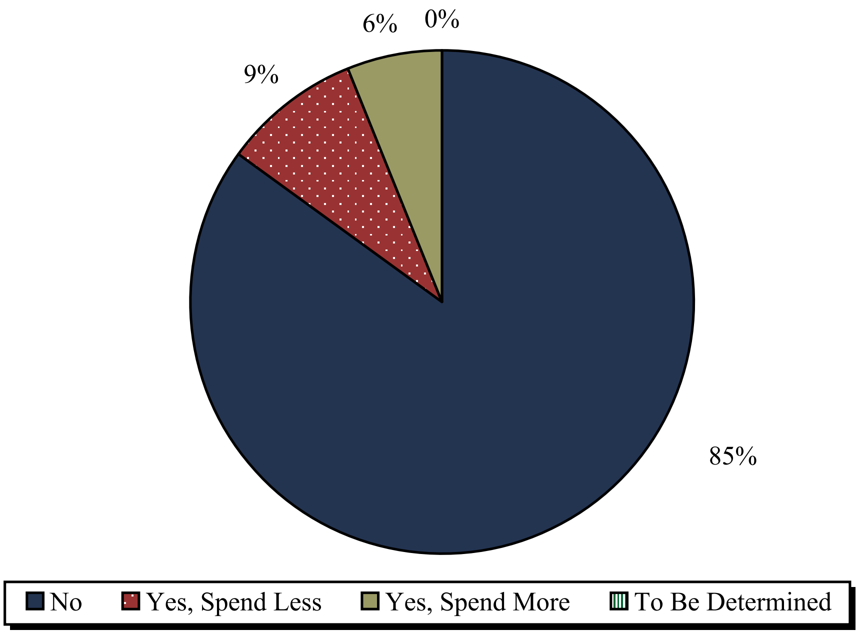
Code	Under Consideration
18	If need be, we will begin to spend return on a larger amount of principal in our portfolio.
20	Hybrid policy is being overridden to control spending. We are increasing spending by 1.5% per year and not taking the full authorized draw. We plan to hold spending at less than authorized for several years. The overall 5% target remains the same.
21	We have drafted an Underwater Endowment protocol, identifying any endowments that are "underwater" as of 12/31, with spending to cease as of 7/1, unless donor approval received.
27	We are limiting distributions on underwater funds.
33	We will reset endowment spending at a lower level and will likely resume our methodology from there. We have done "step-ups" in the past, and this will be a "step-down."
40	Will consider possible further cuts to FY2010 spending at June 2009 meeting if market conditions continue to deteriorate.
41	We will bypass our policy in FY2010 and keep spending constant with FY2009 levels. Plan to return to rule for FY2011.
50	Set aside 12-Q average since it would generate too high a spending rate in the wake of a market value decline we don't believe will be quickly reversed. Goal is to keep spending below 7% of 7/1/09 market value if possible next year. We have determined that program continuity is more important than a mechanistic rule for the next year. We have not yet decided whether to revise our long-term spending policy for future years.
56	Perhaps we will add a temporary cap.
68	Reduce per unit payout by 25% in FY2009 and an additional per unit payout reduction of 25% in FY2010. Then freezing spending at the level reached by the end of FY2010 until no later than the end of FY2013.

Notes: Some institutions have made multiple changes and are listed in each relevant category. Institutions in blue are publicly funded.

Exhibit 3

DO INSTITUTIONS EXPECT TO OVERRIDE THE SPENDING RULE?

Fiscal Year 2008–09



Fiscal Year 2009–10

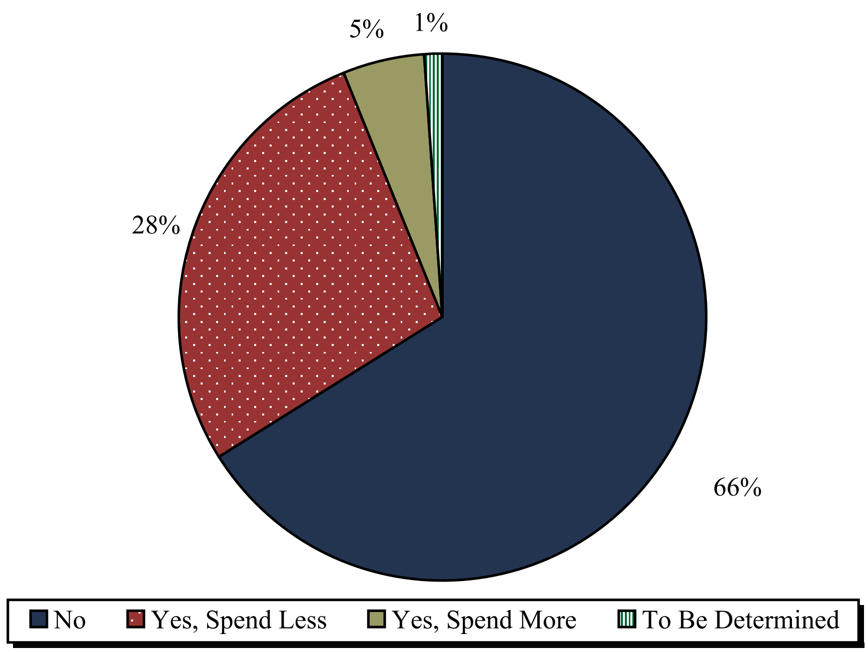
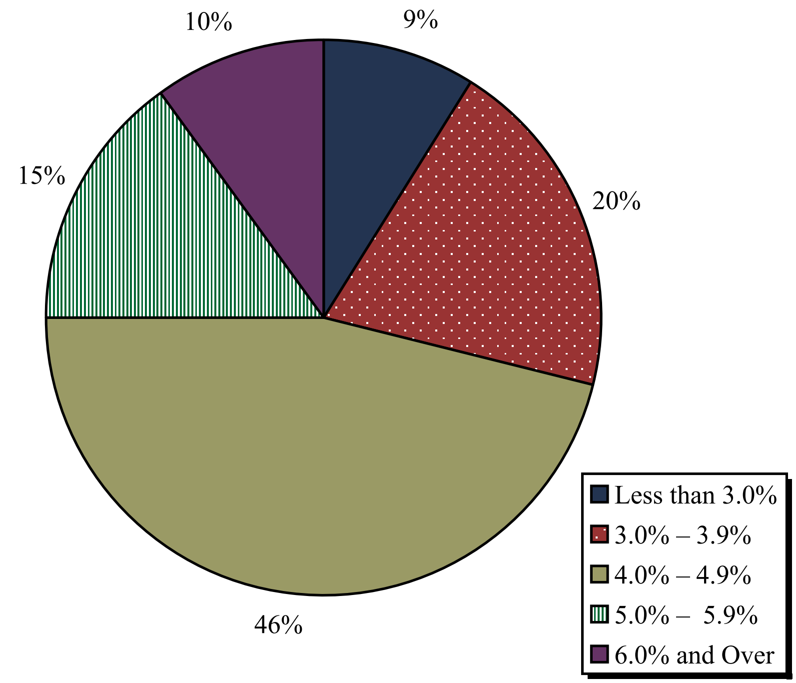


Exhibit 4

ANTICIPATED TOTAL ENDOWMENT WITHDRAWAL FOR 2008–09

As a Percent of Beginning Market Value (June 30, 2008)



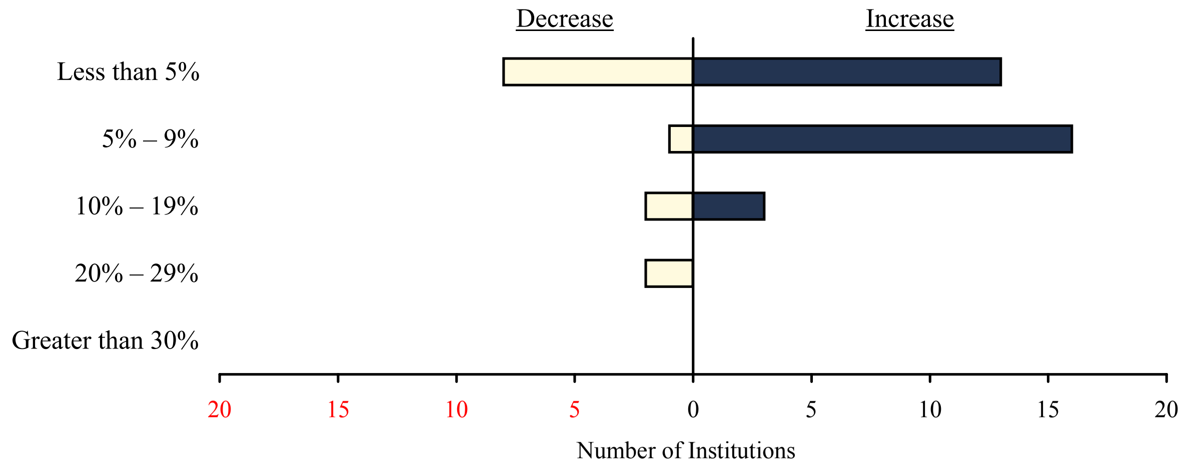
	Number of Institutions	Percent
Less than 3.0%	6	9%
3.0% – 3.9%	13	20%
4.0% – 4.9%	31	46%
5.0% – 5.9%	10	15%
6.0% and Over	7	10%

Note: One institution did not provide data.

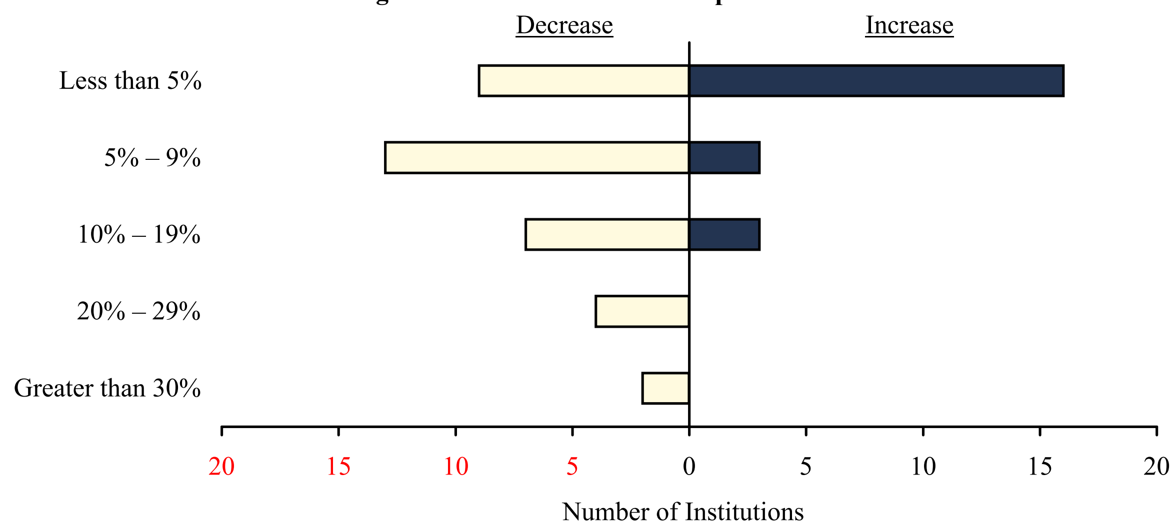
Exhibit 5

TOTAL ENDOWMENT WITHDRAWAL (INCLUDING REGULAR SPENDING DISTRIBUTION)

Percent Change to Total Dollar Value of Expected Withdrawal for 2008–09



Percent Change to Total Dollar Value of Expected Withdrawal for 2009–10

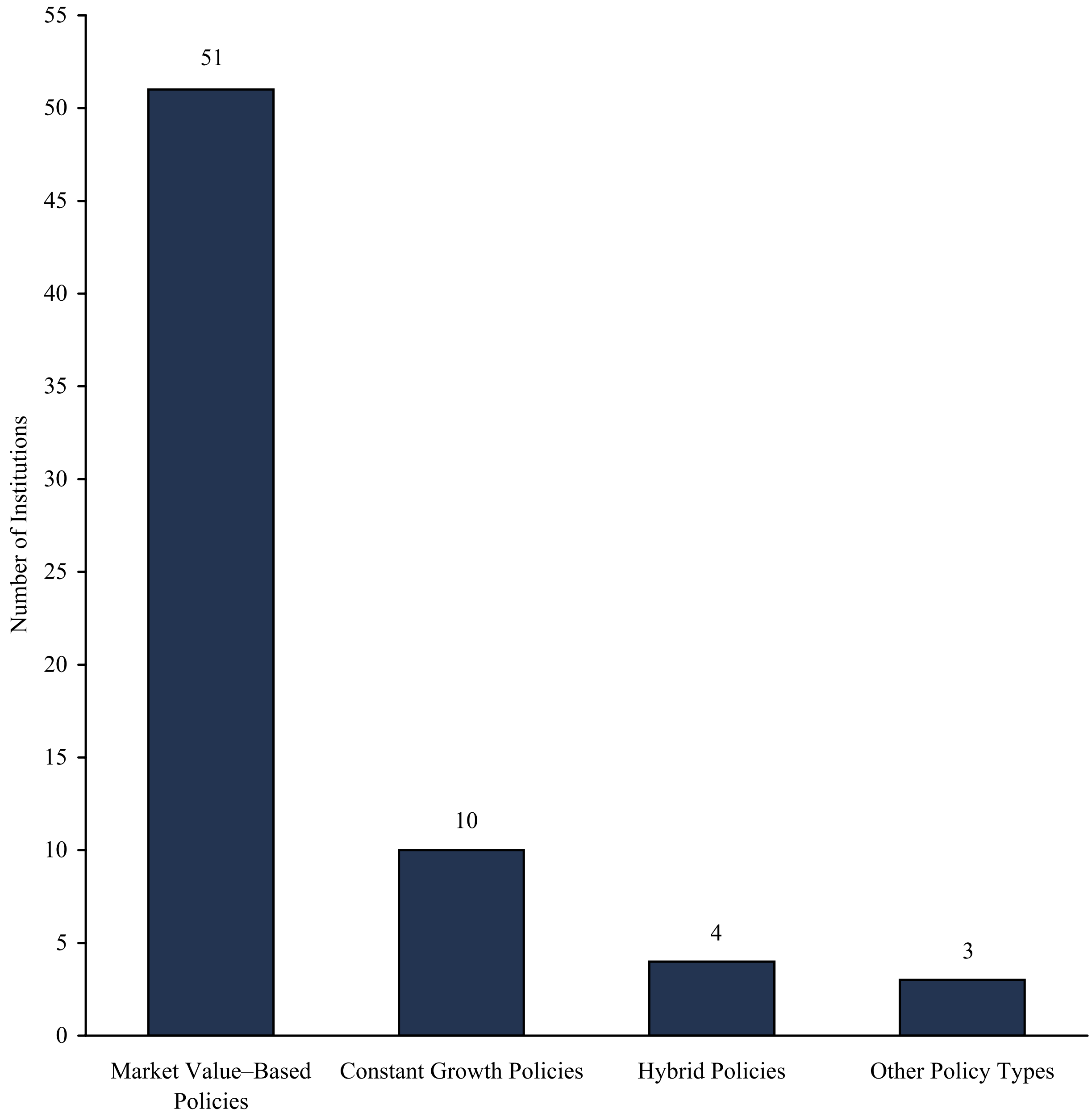


Notes: The remaining institutions did not report changes. In 2008–09, 21 remain the same and two were not provided. In 2009–10, ten remain the same and two were not provided

Exhibit 6A

CURRENT SPENDING POLICY TYPES
(Governing 2008–09 Spending)

By Policy Type

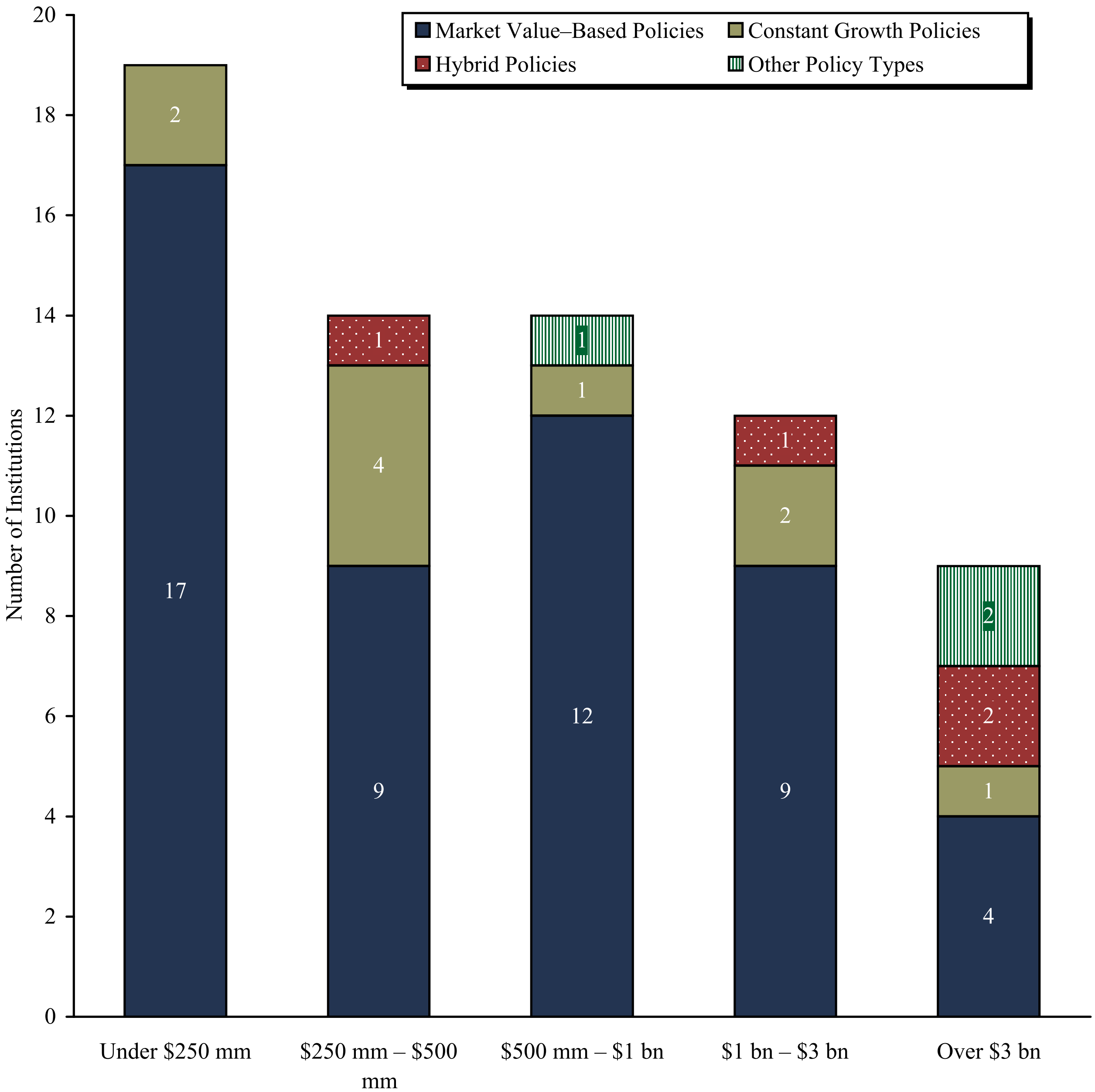


Notes: Hybrid spending policies essentially have the effect of spending a prespecified percentage of an exponentially weighted average market value. The rule is expressed as a weighted average of a constant growth rule and a percentage of market value (or average market value over one to two years) rule. Other spending rule types are those that cannot be classified as market value–based, constant growth, or hybrid policies.

Exhibit 6B

CURRENT SPENDING POLICY TYPES
(Governing 2008–09 Spending)

By Endowment Asset Size

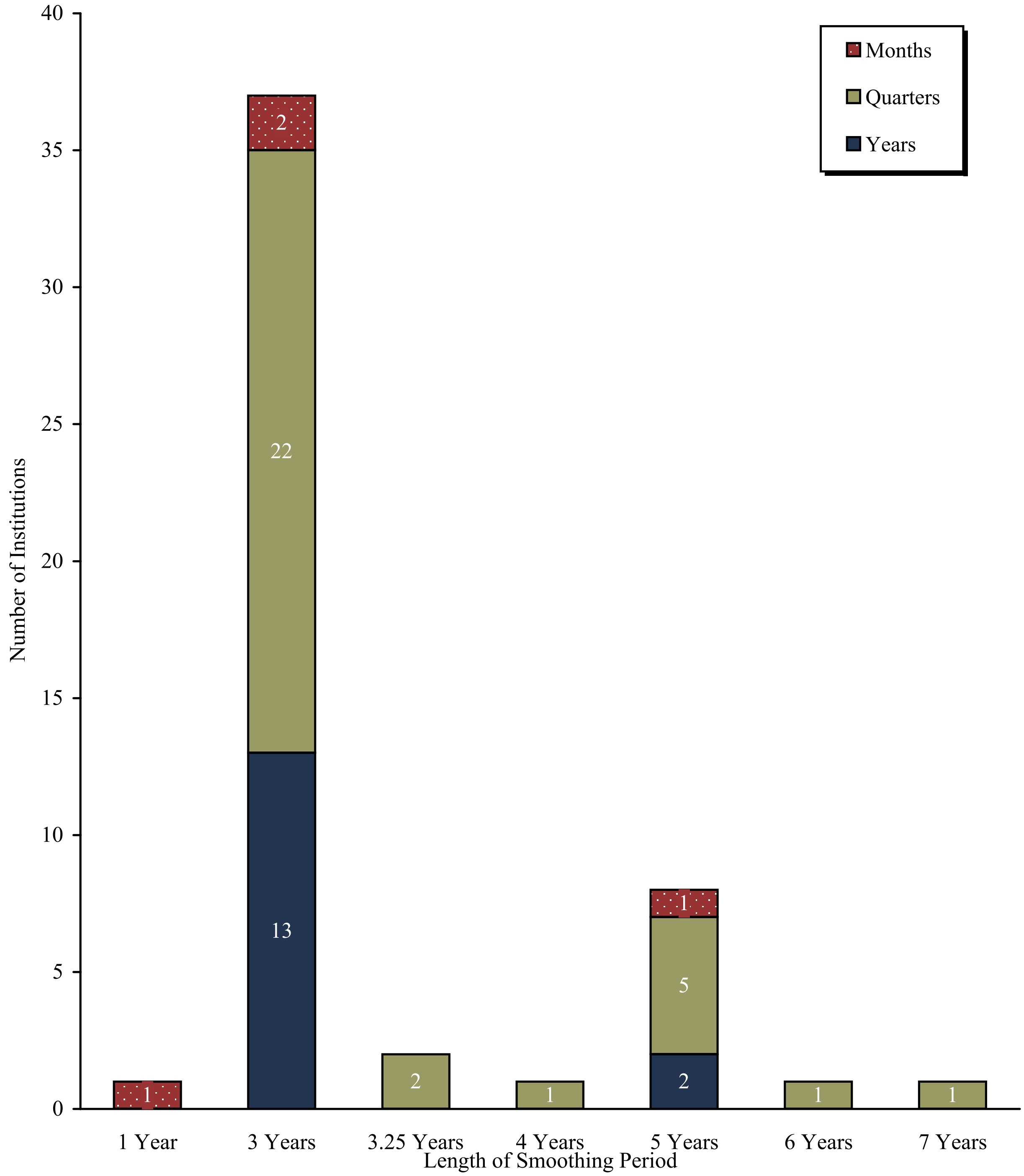


Notes: Hybrid spending policies essentially have the effect of spending a prespecified percentage of an exponentially weighted average market value. The rule is expressed as a weighted average of a constant growth rule and a percentage of market value (or average market value over one to two years) rule. Other spending rule types are those that cannot be classified as market value–based, constant growth, or hybrid policies.

Exhibit 7

SMOOTHING PERIODS FOR MARKET VALUE–BASED POLICIES

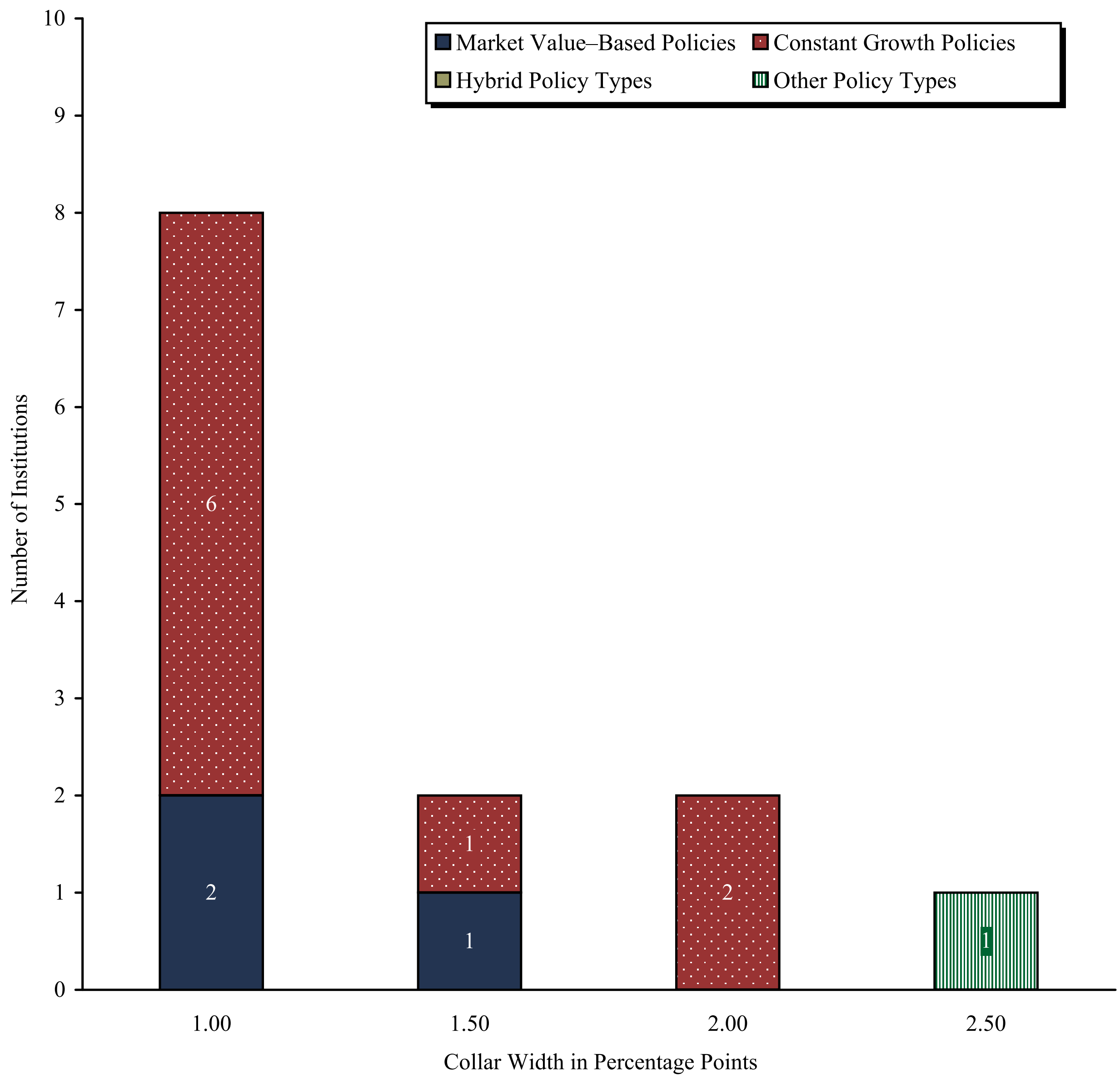
By Unit of Time Measurement



Note: One institution categorized as "3 Years" is calculating a 12-quarter moving average market value with a one-year lag.

Exhibit 8A

COLLAR WIDTH AND SPENDING POLICY
(Governing 2008–09 Spending)



Notes: Of the 68 institutions participating in the survey, 13 indicated the use of a spending collar. Those using only a floor or cap are detailed in Exhibit 3B. Hybrid spending policies essentially have the effect of spending a prespecified percentage of an exponentially weighted average market value. The rule is expressed as a weighted average of a constant growth rule and a percentage of market value (or average market value over one to two years) rule. Other spending rule types are those that cannot be classified as market value–based, constant growth, or hybrid policies.

Exhibit 8B

SPENDING RATE COLLARS, FLOORS AND CAPS

Collars Calculated as Moving Average Market Values
By Number of Occurrences

Midpoint of Floor and Cap	Collar Width (Percentage Point Range) 1.00	1.50	2.00	2.50
4.00			1	
4.25				1
4.50	1		1	
4.75		1		
5.00	6			
5.25	1	1		

Calculation of Other Caps and Floors

Code	Cap Only
10	5.3% of the beginning market value
29	6.0% of a three-year moving average MV
31	4% spending allowances that bring fair market value underwater must be approved by Investment Committee
32	Spending cannot increase more than 10% over the prior year
43	Spending cannot increase more than 10% over the prior year
67	5.0% of a three-year moving average MV

Code	Floor Only
57	Distribution rate cannot be less than the prior year's rate

Participating Institutions

American University
Amherst College
Arizona State University Foundation*
University of Arkansas*
Boston University
Brown University
Carnegie Mellon University
Case Western Reserve University
Chapman University
The University of Chicago
Claremont Graduate University
Claremont McKenna
Colgate University
Connecticut College
Davidson College
University of Delaware*
DUMAC, LLC
Emory & Henry College
Emory University
Hamilton College
Harvey Mudd College
Haverford College
University of Houston*
University of Illinois Foundation*
Iowa State University Foundation*
Kansas State University Foundation*
Kansas University Endowment Association*
University of Louisville Foundation, Inc.*
Lycoming College
Macalester College
University of Miami
University of Michigan*
Michigan State University*
Mount Holyoke

* Institution is publicly funded.

Participating Institutions

Nevada System of Higher Education*
New York University
University of North Carolina at Charlotte*
Northwestern University
University of Notre Dame
University of Oklahoma Foundation*
Pennsylvania State University*
Pepperdine University
University of Pittsburgh*
Pomona College
The Principia Corporation
Purdue University*
Randolph-Macon College
Rosalind Franklin University
St. Lawrence University
University of San Diego
Scripps College
University of Southern California
University of St. Thomas
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Temple University*
Texas A&M Foundation*
University of Texas System*
The Mills College
Trinity University
Vanderbilt University
University of Vermont*
Virginia Tech Foundation*
University of Washington*
Washington & Jefferson College
Washington University in St. Louis
Western New England College
Yeshiva University
York College of Pennsylvania

* Institution is publicly funded.