



California-Nevada United Methodist Foundation

Total Return Spending Policy

History

Historically, non-profit organizations used income from the investment portfolio to make distributions to their cause. As interest rates fell over the past decades, many non-profits found they were reducing distributions to reflect the lower interest and dividend income. In addition, their portfolio asset allocation became over-weighted in income producing assets (i.e., bonds), thereby reducing the allocation to equities, which typically provide long-term growth.

In 1991, California passed adopted the Uniform Management of Institutional Funds Act (California Probate Code, Section 18500-18509) allowing non-profits to spend principal and income by developing a total return strategy. Thus, it may be possible to revise current foundation and/or endowment fund documents to transition from an income-only spending policy to a total return spending policy.

What is a Spending Policy?

A spending policy utilizes the increase in principal appreciation made possible by a total return investment policy. By selecting a percentage rate (usually between 3% and 5%) to calculate the annual charitable payout, an appropriate sum is available for distribution to the various charitable causes served by the foundation and/or endowment fund.

What is Total Return?

Total return is the combination of income and principal change due to market fluctuations. By choosing an asset allocation balanced for growth and income, the investment portfolio should surpass inflation, growing the dollars available for distribution. The asset allocation and spending policy should complement the Investment Policy.

Calculation Methods

Another advantage of a spending policy is that distributions can be calculated and budgeted on an annual basis without immediate concern regarding market changes in principal and income.

There are various methods for calculating the appropriate spending policy. Generally, expenses (such as fees, accounting charges, etc.) will be deducted from the investment portfolio market value before calculating the amount available for distribution.

Many non-profits will use a rolling average in order to smooth out the spending process due to market volatility. For example, using a three-year average market value calculated annually or quarterly will smooth out market fluctuations. This calculation can be done at fiscal year end, calendar year end, or at some point prior to the year-end for budgeting purposes as long as the process is consistent. The spending policy percentage can drive the investment policy or vice versa and should be determined after studying historical returns of the various asset classes.