Memorandum

Subject: Endowment Establishment, Spending Policy, and Management Fees

Purpose

This memo explains how endowments are established, how investment earnings are used, how annual spending is calculated, and how floors, ceilings, and management fees affect the spending plan. The intent is to ensure long-term preservation of the endowment corpus while providing predictable annual support.

Endowment Establishment

Endowments are established by donors with a minimum contribution of **$25,000**. This initial contribution is known as the **corpus** (or principal). Once established, the corpus is invested and earns interest.

The corpus remains permanently intact. **All spending distributions come only from investment earnings**, not from the original corpus.

Initial Investment Period

After an endowment is established, it must remain invested for **one full year** before any spending is calculated or distributed. This allows sufficient time for investment earnings to accumulate and for a market value to be established.

Spending Plan Calculation

First Year of Spending

After the first full year of investment, a spending plan is calculated for the following fiscal year.

- The **initial spending rate** is **4% of the average market value over the prior 12 months**.
- This spending amount represents the first annual distribution from the endowment.

Example – Year 1:

- Corpus: $25,000
- Interest earned: $1,250
- Total market value: $26,250
- Spending calculation:
    - 4% × $26,250 = **$1,050**

The $1,050 represents the first year's allowable spending.

Second Year and Ongoing Spending

In subsequent years, spending is generally increased by **2.5% over the prior year's spending amount**, rather than recalculating a new percentage from market value.

Example – Year 2:

- Prior year spending: $1,050
- Increase: 2.5%
- $1,050 × 1.025 = **$1,076.25**

This approach promotes predictable, steady growth in annual distributions while smoothing the effect of market fluctuations.

Spending Floor and Ceiling

To protect the endowment from excessive spending or underutilization, **minimum and maximum limits** are applied to the calculated spending amount:

- **Floor:**
    - If the calculated spending is **less than 3.5%** of the average 12-month market value, the spending amount will be **increased to at least 3.5%**.
- **Ceiling:**
    - If the calculated spending exceeds **5.5%** of market value, the spending amount will be **reduced to 5.5%**.

Although the actual policy ceiling is **6.5%**, it is reduced to **5.5%** for spending calculations to account for management fees.

Purpose of the Floor and Ceiling

The floor and ceiling exist to ensure the endowment does not go **“underwater.”**
Going underwater means spending exceeds investment earnings and requires dipping into the corpus. The policy is designed to preserve the long-term purchasing power and sustainability of the endowment.

Management Fee

A **1% annual management fee** is charged on the endowment. This fee is considered when calculating the spending plan and is a key reason the practical spending ceiling is set at 5.5% rather than the full 6.5%.

Visual Reference: Floor and Ceiling Guardrails

```
3.5% FLOOR  ←——— Spending Range ———→  5.5% CEILING
     ↑                                    ↑
 Ensures minimum support        Prevents overspending
 without underutilization       and protects corpus
```

These guardrails, along with the 1% annual management fee, are applied to ensure that the endowment remains financially sustainable and does not go underwater by spending more than it earns.

Summary

- Minimum endowment: **$25,000 corpus**
- Spending begins after **one full year of investment**
- First-year spending: **4% of the average 12-month market value**

- Subsequent spending: **prior year spending + 2.5%**
- Spending floor: **3.5%** of market value
- Spending ceiling: **5.5%** (adjusted for management fees)
- Annual management fee: **1%**
- Spending comes **only from earnings**, not the corpus