IC 1

Office of the Treasurer
December 1, 2009

Members, Investment Committee

APPROVAL OF ENDOWMENT SPENDING AND MANAGEMENT FEE POLICIES

Recommendation: that the Investment Committee approve the following changes to Section V. of the Endowment Investment Policy.

V. Financial and Investment Objectives

The Investment Committee has established the following financial and investment objectives for the Endowment:

1. To preserve the purchasing power of the endowment assets and the related revenue stream over time to evenly allocate support between current and future beneficiaries (intergenerational equity).

2. To manage the endowment assets in a single investment pool, employing multiple investment managers to gain specialization and diversification benefits of different investment asset classes and strategies.

3. To establish an annual spending rate policy of ~~4.5%~~ **4.25%** of the average market value over the preceding ~~36~~ **60** months.

4. To establish an annual management fee of ~~.5%~~ **.25%** of the current market value.

5. To earn an average annual real return, after inflation and expenses, of at least ~~5.0%~~ **4.5%** per year over full economic market cycles.

Uniform Management of Institutional Funds Act (KRS 273.520 to 273.590)

Endowment assets will be managed effectively and prudently in accordance with the provisions of the Uniform Management of Institutional Funds Act (KRS 273.520 to 273.590), which specifically requires trustees to consider both the long-term and short-term needs of the University. The Committee has established policies intended to accomplish the primary goal to preserve or increase the purchasing power of the Endowment by maximizing real total return, subject to risk constraints.

Spending Rate and Management Fee

The Investment Committee has established an annual spending rate policy of ~~4.5%~~ **4.25%** of the average market value of the Endowment over the preceding ~~36~~ **60** months to establish financial equilibrium for the Endowment by creating a balance between annual spending and the expected real (after inflation) return on assets. Additionally, the Endowment is assessed an annual management fee of ~~.5%~~ **.25%** of the current market value (assessed monthly) to support administrative costs. The long-term spending rate of ~~4.5%~~ **4.25%** and the management fee of ~~.5%~~ **.25%** in concert with the target asset allocation policy is intended to support current and future program needs and allow the endowment value to grow at least equal to annual inflation.

The above target spending rate and management fee policies will be phased in as follows:

- **In FY 2009-10, the spending rate and management fee will be 4.5% and .5%, respectively. The spending rate will be applied to the average market value over the preceding 36 months.**
- **In FY 2010-11, the spending rate and management fee will be reduced to 4.375% and .375%, respectively. Effective FY 2010-11 and for all future years, the spending rate will be applied to the average market value over the preceding 60 months.**
- **In FY 2011-12, the spending rate and management fee will be reduced to 4.25% and .25%, respectively.**

<u>Background</u>: Due to the recent market downturn and anticipated lower return environment, investment staff requested projections of the Endowment assuming different spending rates from the University's endowment investment consultants [R.V. Kuhns & Associates ("RVK")].

The current value of existing assets is approximately $780 million. RVK projects that the approved target asset allocation and annual withdrawal rate of 5% (4.5% spending and .5% management fee) will reduce the Endowment value to $741 million over a 20-year period. This projection is on an inflation-adjusted basis and assumes a three-year averaging period to calculate spending in each year.

RVK projected future Endowment values based on varying withdrawal rates in the range of 4.0% to 5.0%. An annual withdrawal rate of 4.5% is projected to allow Endowment assets to grow modestly above $780 million, on an inflation-adjusted basis. Calculations performed by University staff indicate that changing from a 36 month to 60 month averaging period will help reduce the short term negative impact of the recent economic downturn. Over the long term, a 60 month averaging period will help smooth out the year-to-year changes in spending distributions during periods of extreme market volatility.

Action Taken: ☑ Approved ❑ Disapproved ❑ Other ___________________