VII. STANDING COMMITTEES

B. Finance, Audit and Facilities Committee

Consolidated Endowment Fund Spending Policy

RECOMMENDED ACTION:

It is the recommendation of the Finance, Audit and Facilities Committee that the Board of Regents adopt a new spending policy for the Consolidated Endowment Fund (CEF) that will decrease per unit distributions by 25% annually in FY09 and FY10 after which per unit distributions will be held constant at the FY10 level.

This policy will be revisited by the Finance, Audit and Facilities Committee no later than 6/30/2013 to determine the appropriate next steps.

BACKGROUND:

The sharp and rapid decline in financial markets worldwide has severely impacted endowment values. The CEF lost 25% of its value in the first six months of fiscal year 2009 with additional declines posted over the past two months as the global recession continues to unfold. The extreme volatility and downward price pressures have not yet impacted endowment spending due to the averaging mechanism in the spending policy.

SPENDING POLICY OBJECTIVES:

At the heart of endowment investment planning is the attempt to balance the following objectives:

- Balance the competing demands of present and future generations;
- Maximize the stability and predictability of distributions;
- Be understandable to donors and campus.

SPENDING OPTIONS:

Over the past few months, the Treasury Office worked closely with Cambridge Associates to model alternative spending policies. As it became increasingly apparent that the global recession would be far deeper and prolonged than originally anticipated, spending options which more quickly recognized the loss already experienced in endowment values were pursued. By the end of December 2008, slightly less than half of the endowments in the CEF were “underwater”, i.e. market value was lower than the original gift. Conversations with campus departments confirmed that many endowed programs were holding a year or more

Consolidated Endowment Fund Spending Policy (continued p. 2)

of operating cash in reserve. This will soften the drop in spending and allow campus departments to readjust their programs to a sustainable level.

A drop of 25% in per unit distributions in both FY09 and FY10 reflects today's economic and financial reality. It helps preserve the liquidity of the endowment and protect underlying assets. The recommended action provides a balance between the interests of current and future beneficiaries. Holding per unit distributions at the level established by the end of FY10 through FY13, acknowledges that it will take a very long time to recover from the current devastating economic conditions.

REVIEW AND APPROVALS:

This policy recommendation has been reviewed by the Senior Vice President and the administration, the Chief Investment Officer and by the University's investment consultant, Cambridge Associates.

Attachments

Attachment 1

SPENDING POLICY COMPARISONS – A SUMMARY

QUESTION	(1) 12% cut for 5 Yrs then spend 5% of 5yr moving average	(2) 5% of a 3 Yr moving average *(current policy)*	(3) 4% of a 5 Yr moving average	(4) 25% cut for 2yrs then freeze spending until market value returns to $2.1 billion	(5) 0% spending until market value returns to $2.1 billion then resume current policy
What is the impact on spending through FY10 (next 6 quarters)?	20%↓ GRADUAL,PREDICTABLE DECLINE IN SPENDING	3%↓ LAGGED RESPONSE TO MARKET DECLINE	20%↓ SLOWER TO RESPOND ON BOTH THE DOWNSIDE AND THE UPSIDE	42%↓ QUICK RESPONSE TO MARKET DECLINE	100%↓ IMMEDIATE IMPAC T
How deep are the spending cuts relative to FY08 and when is the low point reached?	45% by Year 5 *(FY13)*	37% by Year 6 *(FY14)*	46% by Year 7 *(FY15)*	42% by Year 2 *(FY10)*	100% by Year 2 *(FY10)*
How much is distributed over the next 5 years (through FY13) to current programs? (Assumes no new gifts)	$338 million	$395 million	$347 million	$293 million	$50 million *(first half of FY09)*
Over the 12 years? (through FY20)	$837 million	$882 million	$749 million	$677 million *(Freeze in effect through FY20)*	$479 million *(spending resumes FY16)*
How long does it take before the CEF reaches its 6/30/2008 level of $2.1 billion? (Assumes conservative new gift flows)	10 Years *(FY18)*	11 Years *(FY19)*	10 Years *(FY18)*	9 Years *(FY17)*	7 Years *(FY15)*

CONCLUSIONS:

It will take a very long time for the CEF to recover from its dramatic loss in value.

Reduced spending levels represent a relatively small percent of the recovery. Only a return to normal markets along with a resurgence in donor gifts will make a difference.

Options differ in how steadily or abruptly the spending changes are implemented.

SPENDING POLICY COMPARISONS

Fiscal Year	CEF Total Return Forecast	Assumes no New Gifts — 25 % cut for 2 years followed by a freeze until Market Value returns to $2.1B					Assumes Gifts of $36 Million Annually — 25 % cut for 2 years followed by a freeze until Market Value returns to $2.1B			
		Total Distributions	Δ From FY08	CEF Market Value	Δ From FY08	Effective distribution rate	Total Distributions	Δ From FY08	CEF Market Value	Δ From FY08
FY08	2%	$ 94.3		$ 2,161.4		4.36%	$ 94.3		$ 2,161.4	
FY09	-28%	$ 73.2	-22.4%	$ 1,518.4	-29.7%	4.82%	$ 75.4	-20.0%	$ 1,593.3	-26.3%
FY10	-10%	$ 54.9	-41.8%	$ 1,304.1	-39.7%	4.21%	$ 58.5	-38.0%	$ 1,402.4	-35.1%
FY11	0%	$ 54.9	-41.8%	$ 1,235.2	-42.9%	4.45%	$ 60.0	-36.4%	$ 1,363.5	-36.9%
FY12	8%	$ 54.9	-41.8%	$ 1,266.3	-41.4%	4.34%	$ 61.6	-34.7%	$ 1,434.2	-33.6%
FY13	10%	$ 54.9	-41.8%	$ 1,326.0	-38.7%	4.14%	$ 63.1	-33.1%	$ 1,538.6	-28.8%
FY14	13%	$ 54.9	-41.8%	$ 1,433.6	-33.7%	3.83%	$ 64.6	-31.5%	$ 1,700.4	-21.3%
FY15	15%	$ 54.9	-41.8%	$ 1,585.7	-26.6%	3.46%	$ 65.9	-30.1%	$ 1,918.2	-11.3%
FY16	10%	$ 54.9	-41.8%	$ 1,674.8	-22.5%	3.28%	$ 67.2	-28.8%	$ 2,062.8	-4.6%
FY17	10%	$ 54.9	-41.8%	$ 1,772.2	-18.0%	3.10%	$ 68.3	-27.5%	$ 2,219.5	2.7%
FY18	10%	$ 54.9	-41.8%	$ 1,878.5	-13.1%	2.92%	$ 84.9	-10.0%	$ 2,373.8	9.8%
FY19	10%	$ 54.9	-41.8%	$ 1,994.5	-7.7%	2.75%	$ 106.9	13.4%	$ 2,519.4	16.6%
FY20	10%	$ 54.9	-41.8%	$ 2,121.3	-1.9%	2.59%	$ 115.1	22.1%	$ 2,669.9	23.5%

In this example, the freeze is in effect through FY20. Hence, the effective distribution rate drops as markets return to normal and post positive performance.

With the addition of gifts, the market value of the CEF returns to $2.1 billion by FY17. Spending is then calculated at 5% of a 3 year rolling average.

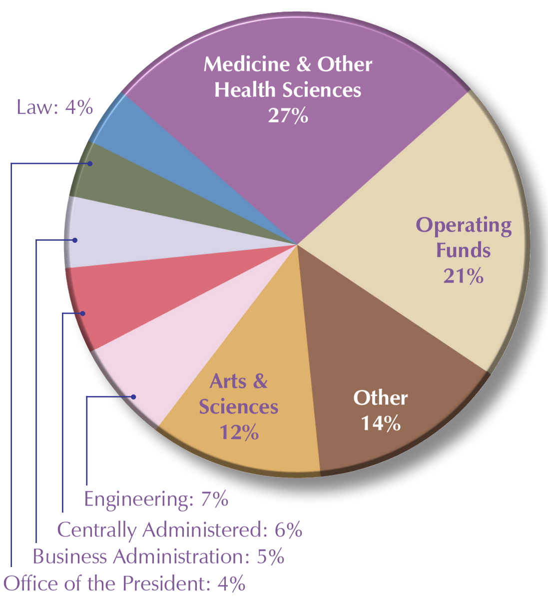
Characteristics of the Consolidated Endowment Fund (CEF)

Endowment Overview as of December 31, 2008 ($=Millions)

Endowed Program Support[1]

Principal by Purpose

Principal by School and College



[1] Includes operating funds invested in the CEF.

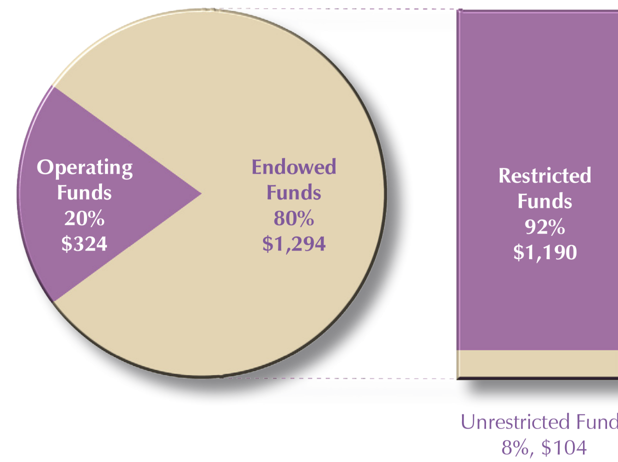
Endowed Dollars Distributed

Endowment Distributions as a % of UW Revenues[2]

Fiscal Years	UW Revenues	Endowment Distributions	%
2004	$1,148	$58	5.0%
2005	$1,251	$62	5.0%
2006	$1,404	$70	5.0%
2007	$1,746	$81	4.7%
2008	$1,410	$94	6.7%

[2] Source: Annual Reports—Excludes Patient Services, other Medical Center revenues, grants and contracts.

Endowment Composition—$1,618



CEF Operating Budget Balances vs. Distributions[3]

	6/30/08 Budget Balances	FY '08 Distributions	Multiple in Years
Faculty Support	$33,410	$23,600	1.4
Scholarships & Fellowships	$29,561	$25,253	1.2
General Academic Support	$16,372	$13,398	1.2
Research Activities	$15,682	$9,437	1.7
Other	$ 4,960	$3,727	1.3

[3] Excludes Invested Funds Balances and Intercollegiate Athletics Reserves.

Consolidated Endowment Fund
Illustration of Calculation to Determine Quarterly Payout per Unit
Based on Current Spending Policy

Quarter Ending	CEF Market Value *$ In Millions*	Total Units *In Thousands*	Unit Value *$*	Lagged 12 Quarter Average *$*	Payout per Unit *$*
Dec-05	1,538	19,519	78.81		
Mar-06	1,707	20,596	82.87		
Jun-06	1,690	20,754	81.41		
Sep-06	1,723	20,973	82.17		
Dec-06	1,841	21,087	87.30		
Mar-07	1,947	21,525	90.46		
Jun-07	2,074	21,793	95.14		
Sep-07	2,166	22,029	98.33		
Dec-07	2,192	22,248	98.55		
Mar-08	2,100	22,637	92.78		
Jun-08	2,161	23,374	92.47		
Sep-08	1,907	23,802	80.32		
Dec-08	1,621	24,132	67.19	88.39	**$ 1.10**

Steps to calculate spending per quarter:

1	Determine the prior quarter-end CEF market value.
2	Divide by total number of units as of the prior quarter end to determine the unit value.
3	Calculate the twelve quarter average unit value using the preceeding twelve quarter ending unit values.
4	Apply a quarterly rate of 1.25% to the twelve quarter average unit value.
5	Make distribution to unit holders during the last month of current quarter, e.g., the average through September is used for the December payout.

Current Spending Policy:

Five percent of the average market value of the CEF for the previous three years. Distributions are calculated on a twelve quarter rolling average basis.

Consolidated Endowment Fund

Historical and Projected Distributions, Market Value and Effective Spending Rate

Comparison of Current and Recommended Spending Policy

(dollars in thousands)

Fiscal Year	Distributions	Market Value	Effective Distribution Rate	
FY99	$ 22,600	$ 677,114	3.3%	
FY00	26,165	868,525	3.0%	
FY01	37,138	851,727	4.4%	*Cap lifted*
FY02	55,206	1,013,829	5.4%	
FY03	56,814	1,010,067	5.6%	
FY04	57,908	1,216,489	4.8%	
FY05	61,505	1,387,891	4.4%	
FY06	69,343	1,689,528	4.1%	
FY07	80,695	2,073,519	3.9%	
FY08	94,315	2,161,438	4.4%	

If policy remains unchanged:

Fiscal Year	Distributions	Market Value	Effective Distribution Rate
FY09	$ 105,993	$ 1,563,047	6.8%
FY10	101,261	1,334,739	7.6%
FY11	87,247	1,269,701	6.9%
FY12	73,587	1,321,514	5.6%
FY13	69,231	1,409,214	4.9%
FY14	70,005	1,549,458	4.5%
FY15	74,377	1,736,385	4.3%
FY16	80,956	1,850,146	4.4%
FY17	88,217	1,996,878	4.4%
FY18	95,132	2,087,205	4.6%
FY19	101,205	2,212,322	4.6%
FY20	107,245	2,342,708	4.6%

Recommended policy change:

Fiscal Year	Distributions	Market Value	Effective Distribution Rate
FY09	$ 75,425	$ 1,593,256	4.7%
FY10	58,486	1,402,394	4.2%
FY11	60,014	1,363,506	4.4%
FY12	61,596	1,434,197	4.3%
FY13	63,138	1,538,510	4.1%
FY14	64,597	1,700,412	3.8%
FY15	65,941	1,918,195	3.4%
FY16	67,175	2,062,786	3.3%
FY17	68,339	2,219,461	3.1%
FY18	84,905	2,373,825	3.6%
FY19	106,924	2,519,389	4.2%
FY20	115,119	2,669,877	4.3%

Notes:

Gifts are included in above illustrations.

Recommended policy lowers effective distribution rate by 2-3% compared to current policy.

Return to $2.1 billion occurs two years sooner with recommended policy.

Endowed Scholarship #2
Established in 2001 With $100,000 Gift

	Fiscal Year		Market Value	Δ From Prior Yr	Fiscal Year Distributions	Δ From Prior Yr	Effective Dist. Rate	CEF Total Return
ACTUAL	FY01	(1)	$ 96,036	-4%	$ 2,323	na	na	-5.0%
	FY02		85,528	-11%	4,798	na	5.6%	-3.9%
	FY03		81,343	-5%	4,744	-1%	5.8%	0.8%
	FY04	(2)	89,779	10%	4,409	-7%	4.9%	17.8%
	FY05		96,091	7%	4,335	-2%	4.5%	12.5%
	FY06		107,072	11%	4,584	6%	4.3%	17.8%
	FY07		125,136	17%	4,971	8%	4.0%	23.3%
	FY08		121,624	-3%	5,492	10%	4.5%	1.9%
PROJECTED	FY09	(3)	85,443	-30%	4,119	-25%	4.8%	-28.0%
	FY10		73,383	-14%	3,089	-25%	4.2%	-10.0%
	FY11		69,503	-5%	3,089	0%	4.4%	0.0%
	FY12		71,253	3%	3,089	0%	4.3%	8.0%
	FY13		74,616	5%	3,089	0%	4.1%	10.0%
	FY14		80,669	8%	3,089	0%	3.8%	13.0%
	FY15	(4)	89,226	11%	3,089	0%	3.5%	15.0%
	FY16		94,242	5.6%	3,089	0%	3.3%	10.0%
	FY17		99,720	5.8%	3,089	0%	3.1%	10.0%
	FY18		105,701	6.0%	3,089	0%	2.9%	10.0%
	FY19		112,233	6.2%	3,089	0%	2.8%	10.0%
	FY20		119,366	6.4%	3,089	0%	2.6%	10.0%

(1) This endowment was invested midway through the fiscal year.

(2) Due to averaging formula, declines in distributions lag declines in market value. Conversely, distribution levels are slow to reflect improved market conditions. This intentional dampening of market volatility is the key benefit of the averaging formula.

(3) The recommended spending policy accelerates the expected decline in spending rather than allowing a lagged response as would occur under current policy.

(4) Distributions are held flat at FY10 levels to facilitate recovery in market value. The effective distribution rate declines as

Endowed Scholarship #1
Established in 1990 with $100,000 Gift

	Fiscal Year		Market Value	Δ From Prior Yr	Fiscal Year Distributions	Δ From Prior Yr	Effective Dist. Rate	CEF Total Return
ACTUAL	FY91		$ 99,397	-1%	$ 4,691	na	4.7%	5.5%
	FY92		106,200	7%	4,926	5%	4.6%	12.5%
	FY93		114,940	8%	5,156	5%	4.5%	14.0%
	FY94		109,749	-5%	5,414	5%	4.9%	0.6%
	FY95		123,236	12%	5,643	4%	4.6%	18.9%
	FY96		139,723	13%	5,925	5%	4.2%	19.5%
	FY97		160,373	15%	6,222	5%	3.9%	20.6%
	F798		182,468	14%	6,533	5%	3.6%	19.2%
	FY99		196,621	8%	6,859	5%	3.5%	14.9%
	FY00		231,217	18%	7,202	5%	3.1%	21.9%
	FY01	*(1)*	211,784	-8%	9,505	**32%**	4.5%	-5.0%
	FY02		188,610	-11%	10,580	11%	5.6%	-3.9%
	FY03		179,381	-5%	10,462	-1%	5.8%	0.8%
	FY04	*(2)*	197,985	10%	9,729	-7%	4.9%	17.8%
	FY05		211,904	7%	9,560	-2%	4.5%	12.5%
	FY06		236,120	11%	10,109	6%	4.3%	17.8%
	FY07		275,957	17%	10,962	8%	4.0%	23.3%
	FY08		268,212	-3%	12,112	10%	4.5%	1.9%
PROJECTED	FY09	*(3)*	188,423	-30%	9,084	-25%	4.8%	-28.0%
	FY10		161,828	-14%	6,813	-25%	4.2%	-10.0%
	FY11		153,270	-5%	6,813	0%	4.4%	0.0%
	FY12		157,132	3%	6,813	0%	4.3%	8.0%
	FY13		164,546	5%	6,813	0%	4.1%	10.0%
	FY14		177,896	8%	6,813	0%	3.8%	13.0%
	FY15	*(4)*	196,766	11%	6,813	0%	3.5%	15.0%
	FY16		207,827	5.6%	6,813	0%	3.3%	10.0%
	FY17		219,907	5.8%	6,813	0%	3.1%	10.0%
	FY18		233,098	6.0%	6,813	0%	2.9%	10.0%
	FY19		247,503	6.2%	6,813	0%	2.8%	10.0%
	FY20		263,233	6.4%	6,813	0%	2.6%	10.0%

(1) The 5% cap on spending was removed in December, 2000 resulting in large increases in distributions in FY01 and FY02 and dampened decline in FY03.

(2) Due to averaging formula, declines in distributions lag declines in market value. Conversely, distribution levels are slow to reflect improved market conditions. This intentional dampening of market volatility is the key benefit of the averaging formula.

(3) The recommended spending policy accelerates the expected decline in spending rather than allowing a lagged response as would occur under current policy.

(4) Distributions are held flat at FY10 levels to facilitate recovery in market value. The effective distribution rate declines as market value increases.