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# Foundation Spending Strategy: Meeting the Moment in 2020 and Beyond

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*This year has been incredibly difficult.*

*One of the most contentious and turbulent presidential elections and transitions in American History. COVID-19 and the consequential social and economic impacts. National protests responding to racism and police brutality. Wildfires ravaging parts of the west coast. These are just a few of the urgent challenges facing the country and the world at this moment.*

Whatever your foundation's mission, it has been and will continue to be influenced by these and many other challenges. Private foundation board members, investment committees and senior staff are charged with the fiduciary responsibility to make informed decisions when guiding the investment and spending activities of their organization. In philanthropy, we always talk about stewarding endowment resources so that we have adequate money for a "rainy day". Well, in 2020, it seems every day has been a rainy one.

Earlier in the year, the Council on Foundations (COF) launched their Call to Action: Philanthropy's Commitment During COVID-19; with over 790 foundations signing a pledge that outlined a number of ways to meet the moment, including increasing spending. With foundation leaders such as the Ford Foundation taking bold steps towards increasing their ability to spend more, other foundations of all sizes were asking: what can we do to meet the moment? How do we spend more to meet the moment? What should we be considering? What are the implications?

Over the last few months, Commonfund has worked with the Council on Foundations and the National Center for Family Philanthropy on the creation of a new strategy guide for foundations: Balancing Purpose, Payout and Permanence. The guide is designed to provide practical and actionable options for approaching financial stewardship and strategic decision making regarding increased spending in turbulent and uncertain times. Building on that effort, Commonfund and the Council on Foundations recently released the 2019 Council on Foundations-Commonfund Study of Foundations(CCSF). The Study specifically examines the issue of increased giving by demonstrating the impact on endowment value, spending and intergenerational equity through five sample modeling scenarios.

Recently, the Center of Effective Philanthropy (CEP), surveyed 800 foundations and received 236 responses. The report asked a series of questions about how foundations responded to the COF pledge and in what ways. The survey also asked if, and by how much, foundations were increasing their grant-making budgets. Among groups that had reached a decision in this area, 72 percent said they "had or will increase grant making in 2020 beyond what was previously budgeted for the year." Of those, 41 percent said they would increase their grant making budgets by 10 percent or less, 18 percent said they would increase it by 11 to 20 percent, and 12 percent said they would nearly double their grant making budgets, increasing grant making by 91 to 100 percent.[1]

The considerations below are not an exhaustive list. They are meant to include, expand, and enhance the tools, resources, learnings and conversations (and grapple with the fundamental tension) that are already occurring regarding managing the endowment for the long term and spending more to meet the moment.

**Mission—and imagination**

Mission is what you are trying to accomplish, your objectives are your roadmap for how you plan to achieve your mission, and your imagination is what you may need to meet the moment in ways you never...well...imagined. Keeping all three in mind when thinking about increasing your spending will keep you focused on how creatively deploying more dollars today lends itself to responding to critical mission and community related objectives. During these trying times, these instances may be straight forward: preserving and building precious direct service infrastructure (food banks, homeless shelters), bolstering vital civic engagement initiatives (grassroots community organizing) or providing clinical and community-based resources (Personal Protective Equipment (PPE)) to protect and save lives. This moment may also require you to do things that stretch your imagination regarding your mission and your spending. When programmatic opportunities emerge that may require different spending considerations to have an impact, mission and imagination can have a significant impact on increasing spending.

**Operating budget**

The operating budget reflects the day-to-day activities of the foundation. Typically, you calculate foundation related and operational expenses into your overall annual spend, which is enough to cover grants and the operating budget to ensure the continued existence and success of the organization. In particular, the program/admin ratio is a key consideration, as many foundations want to ensure that as good stewards, they are allocating a balanced and reasonable share of their annual spending to operations and grantmaking based on their mission and how they execute on it; with increased spending may come additional staffing and operational considerations.

1 The Chronicle of Philanthropy, Foundations Have Increased Payout and Loosened Restrictions Since Pandemic, Michael Theis, Nov 2020

**Staffing capacity**

With increased grantmaking may come a need to either hire new staff or consultants that allow you to carry out the mission of your foundation. Additionally, exploring different (and imaginative) grantmaking approaches and strategies to support organizations during this time may require additional staff resources with similar and different skill sets. Increasing grants may also have knock-on effects for the organizations you support as well. Do they have enough staff and resources to effectively deploy more money? Is your increased commitment for a single year or multiple years? The answer will impact the strategic planning process of your grantees.

**Current/Future cash needs—liquidity**

Current cash needs determine what you need to spend today, while future cash needs project liquidity needed to honor future obligations. Both are important to consider when thinking about increasing spending, especially if, for example, your foundation makes multi-year grants or engages in program related investments or PRIs. PRIs can be structured differently than grants and need to be monitored and accounted for differently. Spending more today will impact your ability to meet future obligations if you do not take both into consideration.

**Existing commitments and total investment returns**

Existing commitments and total investment returns are crucial to consider when thinking about spending more to meet the moment. Existing commitments reflect grant commitments and for those who are invested in alternative strategies that require capital lockups for long periods of time, the capital calls to fund those commitments. On the other hand, total investment returns are the amount a foundation receives from invested capital, including dividends, interest payments, and the appreciation of assets. A foundation deciding to spend more, especially if it is over a period of more than a couple of years, must be cognizant of both their existing commitments and total investment return.

**Spending policy**

Common spending policies calculate annual distribution from an endowment fund by using the following formula: an amount equal to a 5 percent of an endowment's trailing twelve (12) quarter average market value. This reflects the common usage of the three-year trailing average, which provides a smoothing of annual spending to ensure the foundation meets its annual payout and mitigates the risk of not being able to make sufficient grants toward mission in any given year. There are many other spending policies that private and community foundations consider, most commonly:

- Annual percentage of portfolio considering inflation
- Percentage of the portfolio with a smoothing term (three years)
- Percentage of portfolio with a ceiling and a floor
- And a hybrid; a combination of dollar amount grown by inflation and a percentage of portfolio value.

Whatever your spending policy, it is a clear consideration when thinking about spending more to meet the moment.

**Perpetuity horizon**

A perpetuity horizon is the period of time over which the foundation needs to realize investment returns in order to achieve mission. Typically, perpetuity suggests an infinite investment horizon while, in contrast, a spend down foundation has a shorter horizon. The perpetuity horizon should be considered when increasing spending. For foundations who do not have a defined perpetuity horizon, it is healthy to consider defining strategic goals and short, intermediate, and potentially longer-term programmatic and mission related opportunities in the context of increased spending. Would an increase in spending over a certain period lead to greater impact? If you are not mandated in your by-laws and other governing documents to exist forever, should you, especially if assets can be strategically deployed more aggressively to have an impact in a shorter, more defined time frame? What does perpetuity mean to your foundation? How is it defined? Forever? the next 50 years? 100? 150? Or maybe the next 10?

**Governing documents**

Foundations, both private and public, are subject to specific state laws governing investment and spending of endowed funds. Virtually all of the states and the District of Columbia have adopted the Uniform Prudent Management of Institutional Funds Act (UPMIFA), which sets forth requirements that foundations must observe when investing and spending, among other matters. Governing documents set restrictions on spending as dictated by federal, state, and local governments, as well as the organization's bylaws or investment policy statement. For example, the state of Maine has one of the most conservative adoptions of UPMIFA in the country, which means different regulatory considerations when thinking about spending more to meet the moment. All organizations should review and follow these documents, especially during this time when increasing spending seems as urgent as ever. For private foundations, the IRS required minimum spend is 5 percent, but the other considerations listed here may allow some foundations to spend at a higher rate to meet the moment.

**All assets on deck**

Private and community foundations are not investment management firms that just so happen to use some of their excess cash flow for charitable purposes, at their core their mission is to generate social impact. Thinking about how the other 95 percent of the investment portfolio can be strategically deployed to meet the moment has to be a core consideration for foundations, especially now. At the committee level, the investment committee should consider other opportunities to meet the moment other than/in addition to increasing spending. This leaves room for the entire board to review and consider program and mission related investing opportunities.

**Carry-forward on excess distributions**

According to the IRS, if your private foundation distributes more than the mandated 5 percent in a given year, you can use the excess to reduce your required distributions in any taxable year of the "adjustment" period. This refers to the five taxable years that immediately follow the year you made the excess distributions. If you plan to "ramp up" and spend significantly more in the next year/couple years and then ramp back down to traditional spending levels, you may be able to take advantage of your carry forward to help smooth out spending to pre-COVID levels. *Note: Please consult a tax/accounting professional on how this would impact your particular foundation.*

**Asset allocation**

Your asset allocation will determine where to access liquidity to spend more, but will also determine whether/how effectively your portfolio is able to sustain future spending needs. In order to spend more now and still maintain the real purchasing power of the portfolio, a strategically diverse asset allocation with a mix of both liquid and illiquid assets may provide you with the ability to spend more now and capture the benefit of locking up capital in the longer term to generate future growth in the portfolio.

**Diversification**

Diversification is a key component of Modern Portfolio Theory, the cornerstone of developing your foundation's strategic asset allocation. Diversification is varying the types of invested assets in order to combat market volatility, the unpredictability of the market which influences returns. Diversification may help mitigate market risk in a down-year, allowing for constant spending dollars and decreasing the probability of underwater endowments. Even within asset classes, it is important to focus on diversification.

**Donations/Contributions**

Most private foundations are based on an original gift of the founder/or a transaction (e.g. health conversation foundations) and do not typically take in additional contributions. Thus, they are reliant on growth in the portfolio to fund the mission. For community foundations, donations and contributions are any funds gifted to the foundation unrelated to the invested capital. The frequency, predictability, and size of a foundation's donations and contributions can heavily influence a foundation's spending policy and ability to increase its spending to meet the moment, especially if existing gifts are donor restricted. Many community foundations were and continue to raise dollars from existing and new donors to create funds to respond to the COVID-19 crisis.

**Socio-economic conditions**

In 2020, although markets seem to be quickly rebounding, the real economy is not— tens of millions of people are still unemployed and experiencing food and housing insecurity while communities continue to be ravaged by COVID-19. Many social service organizations realize a counter-cyclical impact when the economy is down, and communities are in need. There is an increased need for their services, but individual donations and government contracts may decrease, and in turn, more of a need for foundation support in any given community may need to increase to support nonprofits.

Whether your foundation decides to spend more, keep your spending levels steady, or decrease spending, the truth is these are incredibly trying times. With encouraging developments on vaccines to combat COVID-19 materializing, the hope is that things stabilize over the next few years. Even with a vaccine, communities will need resources to recover and rebuild. Private and community foundations will lean into their missions to meet the moment. Even after this moment passes, these considerations are the building blocks for a more holistic framework and allows other committees, and the entire board, to participate and provide input into how to increase spending to not only meet this moment, but hold space for more integrated strategic governance conversations. Our goal is to provide frameworks, resources, and tools to help hold space to make these decisions.

Additional resources:

Balancing Purpose, Payout, and Permanence: A Strategy Guide for Foundations

Viewpoint: Meeting the Moment

Increasing Giving During COVID-19: Thoughts for Philanthropy

Nonprofit Leaders Spotlight: Dimple Abichandani, ED, General Service Foundation

A Balancing Test for Foundation Spending

Commonfund Xchange | Meeting the Moment | Understanding the Implications of Increased Spending Today

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