Spending Policies and Payout

fig. 13

GOALS OF THE FOUNDERS

Sam and Celia Sanders established the Sanders Family Foundation to share and continue a philanthropic legacy with their children and future generations. Sam and Celia did not intend to spend out the foundation, and indeed had named the foundation as a primary beneficiary of their estate. They did want, however, to see the results of the foundation's grantmaking in their lifetimes, and to realize the joy that came through giving with other family members.

DECIDING ON A SPENDING POLICY

The first step for determining payout was to decide on a spending policy. Sam, Celia, and the rest of the Board decided on a spending policy with an annual payout objective of 8.5 percent — significantly above the required 5 percent minimum payout rate. The foundation's investment advisors explained to the Sanders that this payout rate, combined with the costs of inflation and the administrative costs required to run the foundation, would almost certainly erode the real value of the foundation's initial endowment over time. The Sanders, however, were eager to accomplish as much as possible with the funds they had allocated, and wanted to see the results of their philanthropy in their lifetimes. They also realized that the long-term value of the endowment would be significantly increased by the testamentary gifts they had planned.

DETERMINING PAYOUT

The Sanders Foundation's investment assets at the start of the most recent year were valued at $19.5 million. At the beginning of the year, the board estimated an average value for the foundation of $20 million throughout the year, factoring in their expectations of a gradual appreciation of the assets.* Thus, with an annual spending policy of 8.5 percent, they projected a total payout for the year of $1.7 million ($20 million x 8.5 percent).

The foundation board meets quarterly to decide on grants, and awards approximately one-fourth of the annual grant payout at each meeting. During each of the first three quarters of the year they awarded grants totaling $1.275 million ($425,000 per quarter for three quarters). This left them with approximately $425,000 to distribute at the final meeting of the year, give or take any unexpected gains or losses in the average value of the endowment throughout the year.

CARRYOVER CREATES FLEXIBILITY FOR FUTURE YEARS

Because their spending policy was well above the 5 percent minimum requirement, the Sanders did not have to be concerned with the exact amount of the fourth quarter payment. Indeed, because they were well over the required payment (see box), the Foundation was able to "carry over" approximately $735,000 (the amount that their payout exceeded the required amount) toward payout over any or all of the next five years. Although they did not intend for their spending policy to change in the coming years, Sam and Celia were happy to know that due to the fact that they had exceeded the required payout for several years running, they could easily afford to scale back grantmaking for a year or two if they decided they needed to review the direction or some other aspect of the foundation's future.

DETERMINING THE MINIMUM REQUIRED PAYOUT
for the Sanders Foundation

ITEM	AMOUNT	EXPLANATION
Foundation Assets	$20,000,000	12-month average fair market value of foundation's assets*
Cash Reserve	– $ 300,000	Law allows up to 1.5 percent of endowment value to be "held for charitable purposes"
	$19,700,000	Law requires a minimum 5 percent payout
Payout rate	X .05	
	$ 985,000	This indicates that the foundation has qualified to reduce its tax on investment income from 2% to 1% for year (see Additional Resources)
Excise Tax Credit	– $ 20,000	
Minimum Payout Requirement	$965,000	Payout may be met through grants, administrativeexpenses, and other qualified distributions

*While there is no specified formula for how to calculate required payout, a monthly average is generally accepted as one of the most straightforward and reasonable approaches. To get the average fair market value, add up the value of the endowment on the last day of each month, and divide by 12.

ADDITIONAL RESOURCES

For technical issues related to payout, please consult your advisor or accountant. For additional resources on calculating payout, please see:

- "How to Calculate Your Payout," National Network of Grantmakers http://www.nng.org/html/ourprograms/campaign/calculate_table.htm
- "Calculating the Required Distribution," from *Family Foundation Handbook*, Aspen Publishers, Inc., Washington, DC: 2001, Section 7.04, pages 7-30 to 7-39.
- *Family Foundations and the Law*, Council on Foundations, Washington, DC: 2002, pages 25 - 26 and 40 - 41.

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