

Rochester Area Community Foundation

Total Return Concept and Spending Policy:

Questions & Answers

What is the Total Return Concept?

Overview: Rochester Area Community Foundation is entrusted with carrying out the wishes of its donors in the best interest of the community and with the investment management of its donors' funds. The Community Foundation seeks through its Investment Policy (see separate document) to maintain or increase the real value of the endowment principal and its distributions over the long-term while funding current needs at an appropriate level.

Total Return Concept: The Community Foundation believes that the Total Return Concept (TRC) is the most effective way to invest permanent funds; that there is more to successful investing than merely maximizing current interest and dividend income; and that capital appreciation over time can be significant. Under the TRC, the interest and dividend income plus the appreciation (total market value) of the community foundation's assets are taken into consideration in determining available grant dollars for each year's distribution.

The TRC allows the Community Foundation to set a spending policy that is independent of the interest and dividend income earned by the community foundation's funds and which may be more or less than the actual income earned by interest and dividends in any one year. The spending policy does not produce inordinately high levels of distributions because of high market valuations nor does it produce detrimentally low levels because of market declines, thus smoothing out market volatility.

What are the primary benefits of the Total Return Concept?

Donors can be assured that their funds are being managed in an effective manner that balances current demands and future needs.

The Investment Committee will be able to design long-term strategies aimed at providing a proper balance between income and long-term growth and not subject to sudden shifts in interest rates or market value. The Investment Committee will not be forced to focus their investment strategy on required distributions from income alone.

The Community and Grant Recipients will have a predictable flow of funds to respond to the area's charitable needs and interests. Because distributions are based on a percent of the market value of the Community Foundation's funds, the amount available for distribution should slowly increase over time due to long-term investment growth and a responsible spending rate.

Are there any negative considerations?

It depends on your point of view. Since the spending level is smoothed out, the grant recipients won't receive windfalls that could occur in periods of high market valuations. On the other hand, recipients won't have cutbacks in periods of market declines.

What would happen if the community foundation didn't use the Total Return Concept?

- It could cut current grant making when income is reduced by lower yielding investments.
- Investment managers could be pressured to lower the quality of investment bonds in order to get more current yield if current interest rates drop off.
- Investment managers could sell some common stocks to redirect money into bonds to achieve a greater current yield, thus limiting future growth potential.

The Investment Committee believes that all of the above are poor choices.

In summary, the TRC allows the Community Foundation to be consistently responsible to near-term needs while positioning its funds to maintain purchasing power and grant making capability over the longer term.

How is the spending level determined?

The level of spendable income is set at five percent (5%) of the rolling twenty-quarter average market value of the endowment funds. Spendable income includes interest, dividends, and appreciation. The spending policy adjusts for unusual market fluctuations, thereby giving predictability to future distributions. In periods of poor market performance, newer funds may not have enough appreciation to make the full spending policy. In these circumstances, interest and dividends are available for spending. The Community Foundation's administrative fee structure for endowment funds is separate.

While this may sound complicated, it is actually quite easy to administer. The important points to remember are that the relative stability and predictability of our grant making will be further enhanced and the value of our funds will be protected and increased over time.