Community Foundation
for Kingston & Area

Spending Policy:
Endowment, Spend-Down, Operating Endowment, & Flow Through Gifts/Funds

Approved on: November 28, 2023

It is critical that the Spending Policy for Endowment and Spend-Down Funds consider the viability of the Endowment Funds and compliance with government regulations.

1. The Foundation will charge each fund a standard administrative fee based on the Foundation's *Fund Administration Fees Policy*. The fee will commence with the first full quarter of the fiscal year that the fund is established. This charge will be made even if it causes the Foundation to encroach on the capital of a particular fund.
2. Unless specifically addressed in the Fund Agreement, the following rules will apply in the initial year that an Endowment or Spend-Down Fund is created:
   (a) There will be no grants in the following year if the Fund is established after September 30.
   (b) If the Fund is established on or prior to September 30, spending for the following year will be determined under the normal policy provided that there is no encroachment of capital based on the Accumulated Capital at the end of the initial year (partial spending is allowed).
3. No spending will happen until the minimum fund balance has been reached as per the Fund Agreement.
4. The following formula will be used to determine the amount Available to Grant for funds for all years other than the initial year:

   (a) Regular Endowment Funds

   i. The amount Available to Grant will be calculated on a 5-year rolling average rate of return as of the end of each December.
   ii. The Foundation's annual administrative fee will be deducted.
   iii. Of the remaining amount, 70% will be used to provide grants, with a minimum pay-out of 3% and a maximum of 5%.
   iv. Any amount Available to Grant in a year but not spent, will be available for granting purposes in the following year in addition to the amount of that year's Available to Grant or, if specifically requested by the donor, this amount may be added to the Accumulated Capital of the fund.
   v. If the granting amount calculated in (iii) above is less than 3% or more than 5% there will be an automatic review of the Spending Policy by the Finance & Audit Committee and a report to the Board will be prepared with any revised Spending Policy recommendations.
   vi. On an individual fund basis, where a regular Endowment Fund is in a deficit (overspent) position at the beginning of the current year, the Finance & Audit

Committee shall consider whether the fund should grant or not. If granting, the Finance & Audit Committee will determine the amount to be granted. This will be done in order to protect the Accumulated Capital of the fund over time.

vii. Granting may exceed the limitations noted above if this is required to meet the requirements of the Act.

(b) Spend-Down Funds ("Enhanced Spending Funds")

The Foundation will provide for an enhanced spending option which will allow for the encroachment on the capital of a fund. The amount Available to Grant under the enhanced spending option will be determined by the greater of:

i. A multiple (2 times) of the amount calculated for regular endowment funds, with a minimum pay-out of 10%.

OR

ii. The minimum established in the Fund Agreement not to be less than 10% of the minimum amount required to establish a Spend-Down Fund.

(c) Operating Endowment Funds

i. Granting for Operating Endowment Funds will be calculated on 5-year rolling average rate of return as of the end of each December. This amount will be transferred to the current operating fund each year. No administrative fees will be charged given that all earnings benefit the Foundation.

ii. 70% of the Available to Grant will be used to provide grants to the Operating Budget, and the remaining 30% will be added to the Accumulated Capital of the Operating Endowment Fund.

iii. On an individual fund basis, where an Operating Endowment Fund is in a deficit (overspent) position at the beginning of the current year, the Finance Committee shall consider whether the fund should grant or not. If granting, the Finance & Audit Committee will determine the amount in order to protect the Accumulated Capital of the Fund over time.

(d) Flow Through Gifts/Funds

In addition to Regular Endowment, Spend-Down, and Operating Endowment Funds, the Foundation offers Flow Through Gifts/Funds to facilitate philanthropy in our community. The following applies to all Flow Through Funds:

i. The Foundation will charge each gift/fund a standard administrative fee based on the Foundation's *Fund Administration Fees Policy*.

ii. Of the remaining amount, 100% will be used to provide grants according to the Donor's wishes provided that the recipient is a qualified donee.

iii. If after three years from the date of receipt of the gift no direction has been given from the donor any remaining funds will become unrestricted funds of the Foundation.

iv. Funds will not be invested.

5. The Foundation will maintain this Spending Policy to ensure there is not encroachment of capital over the long term of its regular Endowment Funds.

6. An automatic review of the Spending Policy will occur every five years beginning in 2019. The next review will be conducted in 2027.

Definitions

Accumulated Capital: All donations made to a fund since its inception.

Annual Pay-out Rate: is the rate used in the spending formula to calculate Available to Grant. This rate is based on the average three-year rate of return.

Available to Grant: The amount of funds that is available for granting after the spending formula has been applied. (Previously termed: annual distributable earnings).

Earnings: Includes all interest, dividends and realized and unrealized gains and losses.

Current Capital: Where an enhanced spending option is used, Current Capital is equal to the Accumulated Capital less any additional spending resulting from the enhanced spending option to the extent that has resulted in a reduction of the original capital. In all other cases, the Current Capital is the Accumulated Capital.

Flow Through Gifts/Funds: These are gifts where the full principle is intended to be gifted to another charity or charities.

Spend-Down Funds: are established by the donor to function similar to an endowment in that the principal is to be retained and invested. However, the entire principal and income will be spent over a period of time. (Previously termed: Enhanced Spending Option).

Approved by: Board of Directors Date: November 28, 2023

Appendix A: Current Process

Each year, the board will approve the Annual Pay-out Rate for the year. The Finance & Audit Committee shall determine how much money shall be disbursed from each Fund for grants in the upcoming year. This Spending Policy provides guidance in making these decisions.

Note: The Finance & Audit Committee should consider for each fund: (a) the Current Capital; (b) the Market Value at the most recent year-end; (c) the amount recommended for disbursement in granting in the current year and (d) the estimated value of the fund after the expenditures of current year disbursements.

Appendix B: History, Background, and Considerations

The Community Foundation for Kingston & Area (the Foundation) is a registered charity designated as a public foundation and must comply with the Income Tax Act (Canada) ("the Act"). A central purpose of the Foundation is to benefit the community over the long term through grants from its Endowment and Spend-Down Funds. Each year, the Foundation reviews the investment return on these funds by considering the Market Value of the Fund at year-end. The investment return includes all income from investments including unrealized capital gains. Decisions must be made annually about how to use this investment return or how to respond when this return is inadequate or negative. The individual nature of each fund must be respected, but each year a uniform policy should apply to all funds.

In developing an appropriate Spending Policy, questions to be addressed include the following. How much of the investment return is to be disbursed in grants? How much should be charged by the Foundation as an administrative fee? Should some of the investment earnings be retained within the individual fund to provide grants in future years when the investment return is less favourable? Should we use some of the fund returns held back in previous years to allow for granting in the current year? Given our long-term mission, should we use some of the return to grow each fund in order to protect the real (after inflation) value of the fund and its future grants? Should we provide for inflation through our ongoing efforts to encourage donors (both existing and new donors) to contribute additional capital? Given the wishes of some donors to provide for a higher level of spending, should we allow for more flexible endowment options that provide for encroachment on capital?

The Spending Policy adopted in September 2005 provided that there would be no encroachment on donated capital unless that was required to meet the requirements of the Act. During the significant market downturn of 2007 and 2008, this resulted in having only a small amount available for granting purposes. This occurred during an economic time when the community needed additional resources. It was felt the Foundation should be in a position to provide a level of constant granting to provide certainty regardless of the economic times. To take the above factors into account, in November of 2010 the Foundation updated its Spending Policy to make two changes. First, a three-year average rate of return was used to try to smooth the volatility in the markets. Second, the spending formula provided for a minimum spending of 2.5% and a maximum of 3.5% based on a specific formula (three-year average rate of return less Foundation administration fees times 70%).

In order to provide more flexibility in meeting the needs of our community and provide for the wishes of some donors to allow for some encroachment on the capital of their funds (recognizing that these funds should still last for a considerable time), in 2014 the Foundation provided for an "enhanced spending option" with respect to any endowment. This resulted in the creation of Spend-Down Funds.

In 2023 there was an automatic review of the spending policy as a result of the granting amount minimum (calculated below) being less than 2.5% due to 2022 market returns. In addition, the Finance & Audit Committee needed to consider the impact of the increase in the Disbursement Quota which requires a spending limit from 3.5% to 5% of assets under administration. The result of this review was as follows:

- The increase in the Disbursement Quota to 5% did not seem to have a significant impact on our spending requirements as, on average, we have historically exceeded the minimum spending requirement by a significant amount. However, there was more volatility in some years as a result of having no maximum in our spending formula.
- The fact that there was no maximum to our spending formula did result in some years where we were required to hold back some spending on a few funds to ensure capital was preserved over the long run.
- There may be the impression in the community that our minimum spending percentage should be increased as a result of the change in the disbursement quota legislation.
- Our modeling resulted in showing that if we set a maximum spending amount at 5%, this would allow us to increase our minimum spending amount to 3% without having a significant impact on capital preservation.
- The fact that the 70% factor has not been applied to the operating endowment funds did result in our having to reduce spending on these funds on a regular basis to ensure capital preservation.
- A comparison of using a five-year average rate of return vs a three-year average resulted in no significant changes to fees or spending over time, provided less volatility in our spending percentage and provided less volatility with respect to preservation of capital
- Based on the above, the spending policy was amended for the 2024 year as follows
    - Change our current spending formula to use the five-year average rate of return,
    - Provide for a minimum spending percentage of 3%,
    - Provide for a maximum spending percentage of 5%, and
    - Apply the 70% factor to our operating endowment funds.

The Foundation is aware that poor investment returns could result in the requirement that a fund encroach on the original capital for a period of time. The Foundation anticipates that based on the historical returns realized by the Foundation and its policy of applying a 70% factor, this will not result in encroachment of donated capital (for regular Endowment Funds only) over the long term.