RUSSELL INVESTMENTS RESEARCH

Understanding the impact of the spending policy

A framework to help support the needs of non-profits for generations to come

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Non-profit fiduciaries seek to balance current needs with preserving purchasing power to support future beneficiaries. The spending policy is the primary tool for managing this trade-off. An effective spending policy can provide a steady anchor for non-profit investors across market cycles.

The spending policy is the articulation of how fiduciaries balance current spending and long-term preservation of purchasing power. In this paper, we unpack the spending policy by breaking it into two components: ***spending rate*** and ***spending methodology***. A clear and well-defined spending policy helps ensure discipline around annual spending and alignment with organizational objectives. However, a spending policy only achieves its intended impact if it is consistently followed. Key insights in evaluating spending policies are:

- Spending above real returns erodes the real asset base
- Spending over 5% is difficult to sustain
- More stable spending policies protect current beneficiaries, but shift risk to future beneficiaries
- Higher spending rates and/or more stable methodologies slow recovery from investment losses
- A policy is only effective if it is consistently followed

This paper provides a framework for non-profit fiduciaries to craft effective spending policies that help them meet their objectives and support the needs of their communities for generations to come.

Spending policy components

A spending policy combines two decisions: spending rate and spending methodology.

An organization's **spending rate** is typically expressed as either a percentage of assets or as a fixed dollar amount to be spent each year. An organization's **spending methodology and its parameters** determine how annual spending is calculated and how quickly spending responds to changes in asset values.

These concepts are illustrated in two sample spending policies in **Exhibit 1**.

Exhibit 1: Sample spending policy components

Spending policy	Spending rate	Spending methodology	Key parameter
5% of 3-year average assets	5%	Percentage of moving average	3-year average
$5 million annually, adjusted for inflation	$5 million	Fixed	Increased with CPI

Spending rate

The primary lever in balancing intergenerational equity is the spending rate. Key considerations in determining the appropriate spending rate are:

- What level of spending will support the impact you want to make on your mission today?
- Is perpetuity an important objective? Or is perpetuity a desired outcome, but not more important than the ability to support the mission at the desired level now?
- Can you tolerate high investment risk associated with seeking high returns?
- Are you able to fundraise? If so, can those inflows subsidize current spending? Or are they only intended to further grow the asset base?

Intergenerational equity requires the spending rate to be in line with or below long-term real returns. Current beneficiaries typically prefer higher spending rates to support their programs and services today. However, if the spending rate is above the real returns, the inflation-adjusted asset base will decline over time, providing less support for future beneficiaries than is given to current beneficiaries. Organizations seeking to maintain purchasing power in perpetuity need a spending rate that is equal to or less than the portfolio's expected real return.

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Exhibit 2 illustrates the probability of supporting various spending rates in perpetuity with a variety of asset allocations. If there is a less than 50% likelihood of maintaining the real asset base over time, then it is expected that the future beneficiaries will receive less support than the current beneficiaries.

Exhibit 2: Forward-looking probability of maintaining the real asset base

Based on spending rate and asset allocation[1]

	Asset allocation					
Spending rate	**100% Bonds**	**20% Equity**	**40% Equity**	**60% Equity**	**80% Equity**	**100% Equity**
3%	46%	60%	68%	70%	69%	67%
4%	25%	36%	50%	55%	59%	60%
5%	12%	17%	30%	40%	46%	50%
6%	3%	6%	17%	29%	37%	41%
7%	<2%	2%	8%	19%	29%	34%

For illustrative purposes only. These calculations do not represent actual future performance and are not guarantees of future results.

- Lower spending and/or higher equity makes perpetuity more attainable.
- Higher equity allocations allow for higher spending.

Lower spending rates and/or higher allocations to equity increase the likelihood of maintaining purchasing power. Spending above 5% creates a meaningful hurdle for organizations seeking to preserve purchasing power in perpetuity, even with a growth-oriented portfolio. Even with a 5% spending rate, a growth-oriented portfolio with a high level of investment risk must be tolerated to have a meaningful likelihood of maintaining the real asset base through time.

In some cases, organizations may choose to spend more than the expected real return, even if the objective is intergenerational equity. There may be instances where spending today results in investments (e.g., construction of a new park) that benefit the community or mission in the present and the future. Organizations can also consider ways to support their future beneficiaries through fundraising – although many non-profits look for fundraising to grow the real asset base, not offset current spending.

[1] Based on Russell Investments June 2026 capital market assumptions. Forecasting represents predictions of market prices and/or volume patterns utilizing varying analytical data. It is not representative of a projection of the stock market, or of any specific investment.

Spending methodology

Despite its relatively lower impact, the spending methodology is a key ingredient in determining how to balance the needs of current beneficiaries with those of future beneficiaries. It determines how quickly market gains and losses affect annual spending levels, and therefore the extent to which market losses impact an organization's current spending or its long-term asset preservation. Key considerations in determining your spending methodology are:

- Is it important to maintain the real asset pool in all market environments to support future generations?
- Do you prefer a known (budgeted) amount of spending? Or have high fixed costs that could not be reduced in the short term?
- Do the needs of your community grow in an economic downturn? And would you prioritize meeting those needs over future generations?

More stable methodologies provide predictable spending but increase uncertainty around future asset preservation following market declines.

Spending methodologies range from stable to reactive. More stable methodologies provide predictable spending but increase uncertainty around future asset preservation following market declines. More reactive methodologies help preserve purchasing power after market declines but require organizations to tolerate greater year-over-year spending variability.

In choosing a spending methodology and defining its parameters, an organization must carefully weigh the trade-offs between predictable spending and protecting the asset base in down markets.

More reactive methodologies help preserve purchasing power after market declines but require organizations to tolerate greater year-over-year spending variability.

The percentage of assets and hybrid rule methodologies often strike a balance between spending stability and long-term asset preservation. The percentage of assets rule looks to spend a set percentage of the asset base, either based on the beginning-of-year value or an averaged value over time. Hybrid rule methodologies base a portion of the spending on a percentage of the value of assets and a portion on the spending level in the previous year. For example, with a hybrid methodology that has a 70% weighting to historical spending, the spending will be set at 70% of the previous year's spending, adjusted for inflation, plus 30% of the spending rate applied to the beginning-of-year market value of assets. Both approaches can provide relatively predictable spending while allowing for some reduction in spending after market losses to help stabilize the asset base. The extent to which spending is stabilized through time depends on the underlying parameters[2]. With the percentage-of-moving-average-assets methodology, the longer the averaging period, the more stable the

[2] For the percentage-of-moving-assets methodology, the parameter chosen is the period of time in which assets are averaged when calculating the asset value that is applied to the spending rate. The longer the averaging period, the less reactive the spending is to changes in the market value of assets. The hybrid methodology instead focuses on the extent to which the current asset value factors into the current year's spending level. It does this by dictating the percentage of the current year's spending that is based on the spending from the prior year with the remainder being calculated as a percentage of the current asset value. The higher the percentage used in the hybrid methodology, the more the spending is fixed year-over-year and less reactive to changes in the market value of assets.

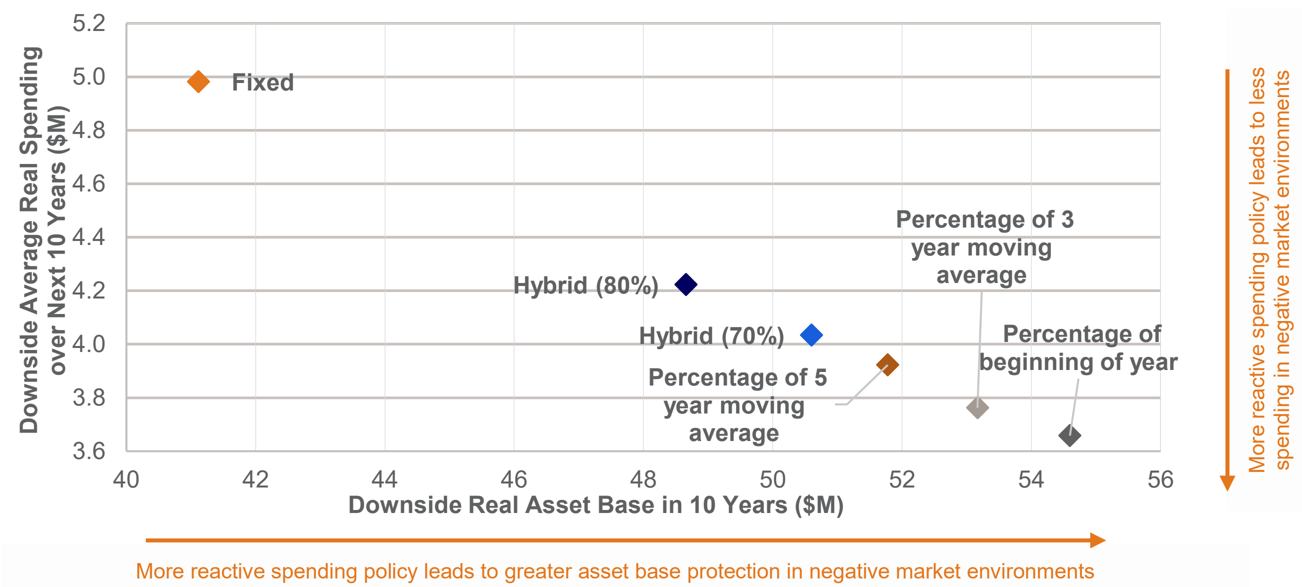
spending is, while a shorter averaging period or the use of the beginning-of-year value creates a more reactive spending policy.

An extreme example of creating stable spending is fixed spending. Fixed spending is when the nominal or real spending dollars remain constant year over year, despite fluctuations in the asset base. Fixed spending can be appropriate when operating costs are difficult to adjust, but it leaves the asset base more vulnerable during periods of market stress.

Exhibit 3 illustrates the expected downside to both real (inflation-adjusted) average spending over the next 10 years and the real asset base in 10 years for a range of spending methodologies. The downside represents the 5th percentile worst outcome at the end of the 10-year period for both the average real spending and real asset base. The most stable spending policy is the fixed policy, while the percentage-of-beginning-of-year-assets policy is the most reactive policy.

Exhibit 3: The expected downside average annual real spending and the real asset base depending on spending methodology

Based on a $100 million starting asset base, a portfolio of 80% equity and 20% bonds, and a 5% spending rate



For illustrative purposes only. Based on Russell Investments June 2026 capital market assumptions. Forecasting represents predictions of market prices and/or volume patterns utilizing varying analytical data. It is not representative of a projection of the stock market, or of any specific investment. Based on an 80% equity and 20% core bonds portfolio. Downside represents the 5th percentile outcome.

Reactive policies help preserve assets in a downturn as shown by having a higher downside asset value but reduce current spending as shown by having more significantly reduced downside spending. Stabilizing the spending shifts risk to the asset base and future beneficiaries, as shown by the fixed spending policy leading to the greatest downside for the asset base.

Stabilizing the spending shifts risk to the asset base and future beneficiaries…

Exhibit 3 focuses on the implications of the spending methodology in negative market environments. The results are different in periods of strong asset performance. In periods of strong asset performance, a more stable spending policy will allow the surplus gains to accumulate for future generations. A reactive spending methodology will spend more of the gains on the current generation, leaving fewer surplus gains to accrue to future generations. However, as long as the real returns are higher than the spending rate in strong investment markets, the expectations of both current and future beneficiaries will be met and therefore the tension between their needs is not as concerning.

Putting it together

Spending rate and methodology work together to determine long-term sustainability and risk to the asset base and spending levels. Organizations with higher levels of spending often adopt aggressive portfolios to ensure the real expected return is in line with the spending rate, creating a greater reliance on market outcomes. When markets decline, higher spending rates lock in a larger share of portfolio losses, making recovery more difficult. **Exhibit 4** demonstrates the likelihood of recovering from a total portfolio drawdown in the first year of 10% or higher within seven years depending on the spending rate and spending methodology.

Exhibit 4: Likelihood of recovering asset base over 7 years from a first-year drawdown of 10% or worse

Based on a portfolio of 80% equity and 20% bonds

	Spending level		
Spending methodology	**4%**	**5%**	**6%**
% of Beginning-of-year market value	61%	52%	39%
% of 3-year average market value	61%	52%	38%
% of 7-year average market value	59%	45%	36%
Fixed spending increasing with inflation	55%	39%	30%

For illustrative purposes only. Based on Russell Investments June 2026 capital market assumptions. These calculations do not represent actual future performance and are not guarantees of future results.

When markets decline, higher spending rates lock in a larger share of portfolio losses, making recovery more difficult.

Higher spending levels make it more difficult to recover from market drawdowns. More stable spending methodologies also delay recovery by maintaining spending levels from a reduced asset base.

The volatility of spending is determined not only by the spending policy, but also by the asset allocation. A less volatile asset allocation will lead to less volatility in the asset base and therefore lower fluctuations in spending even if the spending policy is reactive to changes in the asset base. Whereas an asset allocation that allows for highly volatile returns will lead to greater fluctuations in the asset base, and therefore more volatile spending.

Governance and implementation considerations

An important element of spending is the tendency for an organization to actually follow its spending policy. In practice, this often breaks down, especially if the final spend is determined by a vote of the board. A well-designed spending policy that is not followed will not achieve its intended outcomes. A similar concern is around organizations that have a spending policy that articulates a methodology to spend based on the beginning-of-year or a longer moving-average value of assets, but allow themselves the ability to change the spending percentage each year[3].

Deviations from the spending policy frequently favor current beneficiaries, as they are the ones that are likely to be present in the room. Protecting future beneficiaries requires adhering to the spending policy, despite the urge to spend more than implied by the policy.

The other consideration is the timing of the spending relative to when it is set. Some organizations may have more drawn-out governance processes that lead to the spending based on the results at the end of fiscal year 2025 being spent in fiscal year 2027, not 2026. If this is the case, no matter how reactive the spending policy is, the actual spending will not be nearly as reactive to short-term changes in the market value of assets due to the lag in spending.

While different approaches reflect different priorities, unsustainable policies ultimately fail both current and future beneficiaries.

Conclusions

Spending policy decisions often receive less attention than asset allocation decisions. Yet the spending policy has a large influence on whether future beneficiaries receive the same level of support as current beneficiaries. The spending policy can be designed to ensure intergenerational equity, to maximize current spending, to encourage stable distributions from year to year, or to achieve other goals. A spending policy defines how an organization balances current impact with long-term sustainability. While different approaches reflect different priorities, unsustainable policies ultimately fail both current and future beneficiaries.

A thoughtfully designed spending policy is a powerful tool in times of volatility and uncertainty. The most effective policies are those that are carefully designed and consistently followed.

[3] Based on the 2025 Council on Foundations Study, 27% of private foundations and 11% of community foundations decide on an appropriate rate each year. Based on the 2025 NACUBO-Commonfund Study of Endowments, 4% of endowments decide on an appropriate rate each year.

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