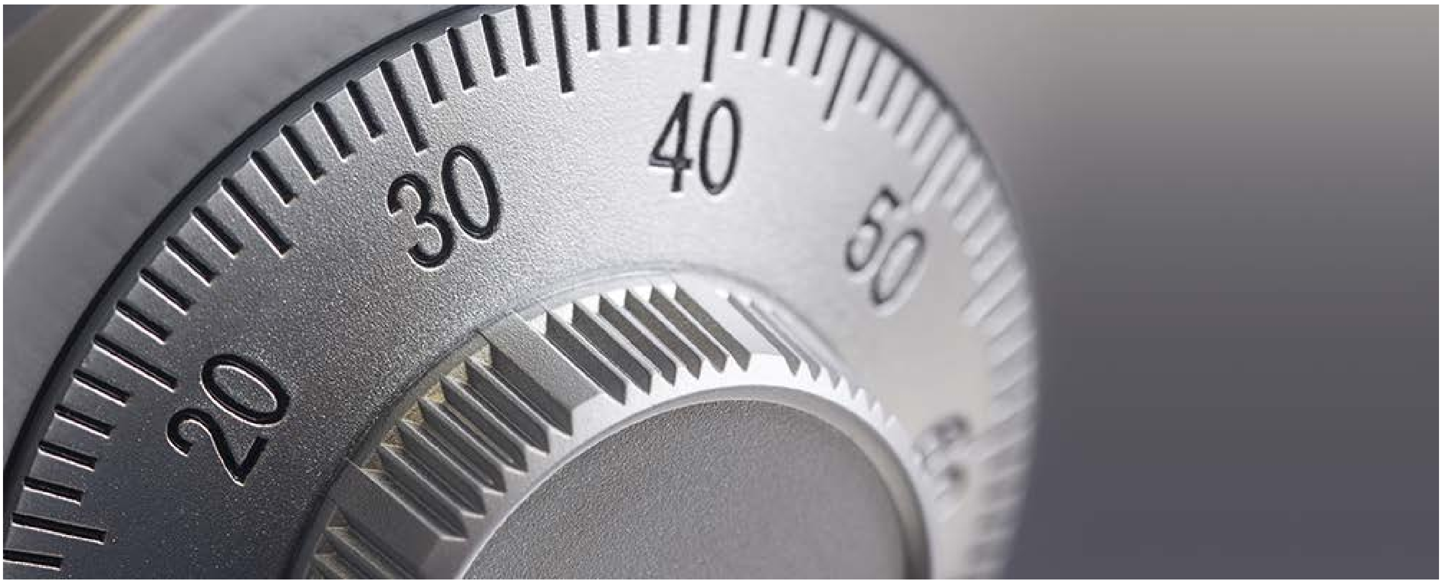
Guest Column

Should you spend capital?

by Kate Sayer from Sayer Vincent



I recently facilitated an awayday for the trustees of a well-established charity that wanted to make a decision about whether they should consider spending some capital. There were no difficult technical issues as the funds were not permanent endowment and so the trustees are free to adopt a total return investment policy. The trustees had recently reviewed their strategy and had decided to extend their reach and their services to a considerable degree. As well as making grants to individuals, the charity operates some care homes and supports other charities. The plan to implement the new strategy had been costed over a ten year period and the purpose of the awayday was to agree a financial strategy to support the strategy.

As part of the awayday, we explored the different approaches to ensure that everyone felt comfortable and able to contribute to the discussion. For example:

- Income-only approach - only the income (dividends, interest) produced and paid over is withdrawn on a regular basis
- Total return investment approach - either income or capital growth is withdrawn from the portfolio on a regular basis
- Social investment – where funds are invested to generate a social return as well as a financial return. For this charity, this applied to some property it owns which is used for charitable purposes and some of it is rented to other charities for their charitable purposes. In such circumstances, the trustees may accept a lower financial return because the investment is charitable.

Previously, the charity's investment strategy was to keep up with inflation as well as generate income, which was used to fund the operational costs and grant-making. Research into the past 20 years of the charity's finances showed that the accumulated capital gains on the portfolio had out-performed inflation by about £16 million. If the charity had adopted a total return policy, this would have been part of the return available to the trustees to spend.

The costed plan showed that the expenditure for the next ten years and more would exceed the income earned from the investments. In addition, some cash would need to be withdrawn from the investments to fund capital improvements to the properties so that these could be developed into exemplar services, as set out in the strategy. The dilemma for the trustees was that the income shortage would be exacerbated by withdrawing cash from the investment portfolio.

As well as working up the options, we gave all trustees a chance to explore how they felt about the proposals and the dilemma. This ensured that we did not just listen to the 'experts' or fall back into thinking that this was a technical issue. What emerged from this part of the discussion was a solid commitment to the strategy and the expenditure plans. Trustees did not want to treat grant-making as a tap they could turn off when income fell as they were committed to supporting the individuals and communities that needed their help.

Trustees therefore decided to make a commitment to underwrite the expenditure plans. This included the capital expenditure. The cash to underwrite the plans could come from capital as necessary, as the portfolio had out-performed inflation. Expenditure plans are prepared for a rolling three-year period and would be reviewed as normal, as would the effectiveness of the strategy and programmes.

The investment committee members agreed to review the investment policy to consider whether a slightly higher risk appetite would enable different asset choices and an increased return on investments. In addition, the investment committee would explore whether a mortgage on one of the properties could be a more cost effective way to finance the improvements, thus removing the need to withdraw cash from investments.

The day ended with all trustees feeling they had embraced new ideas, such as the mortgage and social investment, and challenged themselves to be flexible on their risk appetite to achieve the returns they needed. The decision-making process had been inclusive and transparent, and had deepened everyone's understanding and commitment to the strategy.

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