Understanding Endowments, with an Emphasis on Funds-Functioning-as-Endowments

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With thanks to the following colleagues for assisting with this presentation:
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Agenda

- Endowment fundamentals
- Endowment payout
- Establishing and stewarding an endowment
- Allocations, reallocations and withdrawals
- Resources
- Questions
Endowment fundamentals

What is an endowment?

• Capital invested so that a purpose can be supported in perpetuity
  – A portion of the interest and historical return is used to support the designated purpose

• Established for a wide variety of purposes
  – Faculty chairs
  – Fellowships and scholarships
  – Program and research support

• Gift fund controlled by terms
Endowment fundamentals

Types of endowments

• True endowments
  – Perpetual
    • Principal held inviolate
  – Term endowments
    • Defined period over which fund is depleted
    • Minimum term is 10 years

• Fund functioning as an endowment (FFE)
  – Administrative action
  – Principal held inviolate
    • Can change as there are no legal restrictions
Endowment fundamentals

Endowment pros and cons

• Pros
  – Stable funding source
  – Sustained growth
  – Donor legacies

• Cons
  – Market risk
  – Capitalization requirements
    • Can intent be fulfilled?
  – Restricted funding
Endowment fundamentals

Fiduciaries and investment

• Pools

• UC Regents
  – $7.4B ($2.4B for Berkeley) at 6/30/14
  – Established in 1933 and unitized in 1958

• UC Berkeley Foundation
  – $1.5B at 6/30/14
  – Berkeley Endowment Management Company

• “Berkeley’s endowment” = $3.9B at 6/30/14
Endowment payout

How is payout calculated?

• Annual endowment payout rate
• Aggregate payout amount for the pool
• Moving averages
  – Regents: 60-month
  – Foundation: 12-quarter
• Allocated to individual funds
• Effective payout rate
Endowment payout

How is payout distributed?

• Fund (allocation) numbers
  – Endowment
  – Payout

• Chartstring(s)

• Annually, in August
  – Transfer to Regents ledger for expenditure

• Term endowments and FFEs
  – Return for reinvestment
  – Withdrawals
Establishing and stewarding an endowment

Philanthropic gifts

• Donor intent
  – Legacy

• Minima
  – Ensure sufficient payout
  – $50K and higher for specific purposes

• Fund terms
  – Agreement between donor and University
  – Spendable
  – Contingency
Establishing and stewarding an endowment

Administrative action

• Improve financial stability and retain flexibility
  – Long-term investment

• Capitalization from
  – Gift funds
  – Departmental reserves of fee revenue
  – No legislatively-appropriated funds

• Timing of withdrawals
  – Regents guideline: 5 years
  – Foundation guideline: 3 years
Establishing and stewarding an endowment

Using an FFE

- An FFE created from an unrestricted fund is unrestricted regardless of unit’s intent
  - Payout is unrestricted
- An FFE created from a restricted fund is restricted regardless of unit’s intent
  - Payout is restricted
- When do funds need to be separate?
Establishing and stewarding an endowment

Process for establishing an FFE

• Campus Budget Office
  – Approve strategy
  – Non-gift funds
• Request from Dean or Vice Chancellor
• Fund Management
  – Fund terms
  – Facilitate approval
• Very limited ability to move funds from Regents to Foundation
Establishing and stewarding an endowment

Campus Budget Office

- Campus, division, department perspective
- 1\textsuperscript{st} dollar principal
  - Most restricted dollar
- Unit reserves
- Recent and projected changes in net assets
- Trends in revenue, expense and change in net assets
- Department and division perspective
Establishing and stewarding an endowment

Making the FFE request

• Requestor must be a Dean or Vice Chancellor
  – Broad organizational view

• Must confirm
  – Understand and accept market risk
  – Understand withdrawal guidelines
  – Understand FFE as part of unit’s financial plan
Establishing and stewarding an endowment

Reporting and compliance

- Endowment financial report
- Impact (beneficiary) reporting
- Compliance with terms
  - Spending and accumulation of payout
    - Regents’ policy: 5 years
    - Regents’ guideline: 1 year
  - Use of funds
- Reinvesting income
- Changing terms
Allocations, reallocations and withdrawals

Allocations and reallocations

• Determining or changing purpose or use
  – Transactional
  – Avoid restrictions

• Authorities for gifts and bequests
  – EVCP up to $1M
  – Chancellor up to $5M
  – President over $5M

• Chancellor has unlimited authority for funds to be designated as FFEs
Allocations, reallocations and withdrawals

Withdrawals

• Authorities for withdrawals
  – EVCP up to $1M fund value
  – Chancellor up to $5M fund value
  – President over $5M fund value

• Chancellor can approve withdrawals from FFEs valued at more than $5M if withdrawal does not exceed 5% of value

• From Regents FFEs only during fourth quarter
  – Emergency withdrawal process
Resources

• UC Office of the President, Office of Institutional Advancement, Policies and Guidelines

• Eureka, UC Berkeley’s Advancement Intranet
  https://eureka.berkeley.edu/
Questions

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Talking With Donors About How the Endowment Payout is Calculated (CMT Meeting May 24, 2012)

Key Points:

- Payout is not calculated at the fund level. It is calculated for the General Endowment Pool as a whole and then allocated to individual funds according to the proportion each represents of the whole.

- As we add funds to the endowment portfolio the fact that the aggregate payout is relatively constant means that the payout allocated to each is reduced.

- If a fund is not invested in the General Endowment Pool at the end of the prior fiscal year it will not receive a full year’s worth of payout.

Calculating Endowment Payout: UC Berkeley Foundation (2010-11)

Step 1: Calculate the 12-quarter moving average market value of the General Endowment Pool as of March 31st

\[
\text{Average of quarter-end market values for 6/30/08 thorough 3/31/11} = \$ 829,168,812 \quad (a)
\]

Step 2: Calculate the aggregate payout amount

\[
\text{Multiply by the spending policy rate which was 4.75\% for the August 2011 payout} = \$ 39,385,519 \quad (b) = (a) \times 0.0475
\]

Step 3: Determine each fund’s share of the 4-quarter moving average market value of the General Endowment Pool as of March 31st

\[
\text{Average of General Endowment Pool quarter-end market values for 6/30/10 through 3/31/11} = \$ 944,425,137 \quad (c)
\]

Example A: A fund that has been invested for at least a year

<table>
<thead>
<tr>
<th>Market Value</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>6/30/2010</td>
<td>$ 1,031,142</td>
</tr>
<tr>
<td>9/30/2010</td>
<td>$ 1,075,647</td>
</tr>
<tr>
<td>12/31/2010</td>
<td>$ 1,131,160</td>
</tr>
<tr>
<td>3/31/2011</td>
<td>$ 1,166,710</td>
</tr>
</tbody>
</table>

\[
\text{Average the quarter-end market values for 6/30/10 through 3/31/11} = \$ 1,101,165 \quad (d)
\]
Divide the fund’s 4-quarter average into the General Endowment Pool’s 4-quarter average

\[ 0.12\% \ (e) = (d) \div (c) \]

**Example B: A fund that has been invested for only a portion of a year**

<table>
<thead>
<tr>
<th>Date</th>
<th>Market Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>6/30/2010</td>
<td>$ -</td>
</tr>
<tr>
<td>9/30/2010</td>
<td>$ -</td>
</tr>
<tr>
<td>12/31/2010</td>
<td>$ 1,131,160</td>
</tr>
<tr>
<td>3/31/2011</td>
<td>$ 1,166,710</td>
</tr>
</tbody>
</table>

Average the quarter-end market values for 6/30/10 through 3/31/11:

\[ 574,468 \ (f) \]

Divide the fund’s 4-quarter average into the General Endowment Pool’s 4-quarter average

\[ 0.06\% \ (g) = (f) \div (c) \]

**Step 4: Allocate the payout to each fund based on the proportion of the total General Endowment Pool that it represents**

\[ \text{Example A} = 45,922.07 \ (h) = (b) \times (e) \]

\[ \text{Example B} = 23,957.12 \ (i) = (b) \times (g) \]

**Step 5: Calculate the effective payout rates for the General Endowment Pool and each fund as of March 31st**

Divide the payout by the market value at 3/31/11

<table>
<thead>
<tr>
<th>Market Value</th>
<th>(3.92% \ (b) \div (j))</th>
<th>(3.94% \ (h) \div (k))</th>
<th>(2.05% \ (i) \div (l))</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Endowment Pool</td>
<td>$1,005,622,388</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Example A</td>
<td>$1,166,710</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Example B</td>
<td>$1,166,710</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Key ways in which things differ structurally for the UC Regents General Endowment Pool and payout to Regental funds:**

- The UC Regents use a 60-month moving average rather than a 12-quarter moving average.

- The payout calculation is based on monthly, rather than quarterly, market values.

- Endowment cost recovery reduces payout. For the UC Berkeley Foundation endowment cost recovery reduces investment income.