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

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Agenda

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

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

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 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

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?

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
- 1st 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

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

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 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

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

  http://www.ucop.edu/institutional-advancement/policies-and-guidelines/fundraising/index.html
- 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

Average of quarter-end market values for 6/30/08 thorough 3/31/11 = $ 829,168,812 (a)

Step 2: Calculate the aggregate payout amount

Multiply by the spending policy rate which was 4.75% for the August 2011 payout = $ 39,385,519 (b) = (a) x .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

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

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

		Market Value
6/30/2010	$	1,031,142
9/30/2010	$	1,075,647
12/31/2010	$	1,131,160
3/31/2011	$	1,166,710

Average the quarter-end market values for 6/30/10 through 3/31/11: $ 1,101,165 (d)

Divide the fund's 4-quarter average into the General Endowment Pool's 4-quarter average 0.12% (e) = (d) ÷ (c)

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

	Market Value
6/30/2010	$ -
9/30/2010	$ -
12/31/2010	$ 1,131,160
3/31/2011	$ 1,166,710

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) ÷ (c)

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

Example A =	$ 45,922.07	(h) = (b) x (e)
Example B =	$ 23,957.12	(i) = (b) x (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

	Market Value			
General Endowment Pool	$ 1,005,622,388	(j)	3.92%	(b) ÷ (j)
Example A	$ 1,166,710	(k)	3.94%	(h) ÷ (k)
Example B	$ 1,166,710	(l)	2.05%	(i) ÷ (l)

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.