Endowment: Sample Policies

SCHOOL ENDOWMENT: Sample Policy Statement

WHAT ARE ENDOWMENT FUNDS?

Endowment funds are assets that provide support to the school in perpetuity. The endowment funds are invested and a portion of the investment return provides support to the school’s operations. There are two types of endowment funds: donor specified, or pure, and board designated. When a donor specifies a gift as endowment, the endowment is considered pure endowment. The board of trustees of the school can decide to designate unrestricted funds as endowment. These funds, known as board designated endowments, remain in the endowment until the board decides to change the designation.

Often, donors give money to the school’s endowment and specify that the income, or some portion of the total return, from the gift be used to support a specific function in the school. Examples of common restrictions are financial aid, faculty development and plant maintenance. If the donor does not specify a use, a portion of the total return supports the general operations of the school.

INVESTMENT OBJECTIVES AND SPENDING RATES

The permanent nature of endowment funds creates a challenging objective - maintenance of the purchasing power of endowment assets in perpetuity. Asset allocation and spending policies should be established with a long-term perspective in order for the endowment to maintain its purchasing power. This objective can only be accomplished by linking the school’s investment objectives with its spending policy. Spending at levels that are inconsistent with investment returns will either diminish or enhance future endowment levels. Too much current spending will cause future endowment support for operations to fall; too little current spending will benefit future students at the expense of today’s students and parents. Stated differently, the endowment should provide the same level of support for a designated program this year, next year, and for decades into the future. In summary, the school’s objective is to preserve the real purchasing power of the endowment by seeking long-term returns which either match or exceed the spending rate plus inflation. The trustees should view the school’s endowment as permanent, that is, having a perpetual life. Therefore, the school is willing to rely on projections of long-term market performance and not be overly concerned by short-term reversals in the markets. The general policy shall be to diversify investments within both equity and fixed-income securities so as to provide a balance that will enhance total return while avoiding undue risk concentration in any single asset class or investment category.

It is the policy of the school to annually distribute 4% of the trailing three-year average of the endowment’s total asset value, with the expectation that, over time, the total real return (return net of inflation) from investments will exceed the endowment’s pay-out rate, thus allowing for real growth of endowment assets.
MANAGEMENT OF THE ENDOWMENT

The school's endowment rests with The Common Fund, invested in equity and fixed income funds in accordance with the school’s investment policy.

ENDOWMENT INVESTMENT POLICY

I. GENERAL CONSIDERATIONS

A. The purpose of this policy statement is to articulate the broad guidelines that will be applied to the long-term management of the endowment.

B. The endowment is intended to provide operating support to the school in perpetuity and, accordingly, is invested with a long-term horizon. Although year-to-year volatility is reduced through diversification of investment strategies, the emphasis will be on the long-term, total rate of return.

C. The investment of certain portions of the endowment in the future may be restricted or otherwise designated and thus not subject to the full context of this policy statement.

II. INVESTMENT RETURN

A. The primary objective of the endowment investment portfolio is to generate a long-term, total rate of return (income plus appreciation) that will permit real growth in endowment assets while funding an annual payout rate that is expected to equal roughly 4% of the trailing twelve quarter average market value of the endowment.

B. The specific, long-term annual total return objective for the endowment investment portfolio is approximately 500 basis points above the annual change in the GDP price deflator.
III. ASSET DIVERSIFICATION AND STANDARDS OF PERFORMANCE

A. On average, endowment assets will be invested with a target of roughly 65-70% in common stocks and stock alternatives and 30-35% in fixed income securities. More specifically, the following optimum targets will apply, although frequent movements within the indicated ranges are anticipated due to market fluctuation:

<table>
<thead>
<tr>
<th>Common Stocks:</th>
<th>Optimum</th>
<th>Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic</td>
<td>40%</td>
<td>35-45%</td>
</tr>
<tr>
<td>Foreign</td>
<td>10%</td>
<td>5-15%</td>
</tr>
<tr>
<td>Total</td>
<td>50%</td>
<td>40-60%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Investment Grade Bonds</th>
<th>Optimum</th>
<th>Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic</td>
<td>28%</td>
<td>25-35%</td>
</tr>
<tr>
<td>Foreign</td>
<td>4%</td>
<td>2-10%</td>
</tr>
<tr>
<td>Total</td>
<td>32%</td>
<td>27-45%</td>
</tr>
</tbody>
</table>

Alternative Strategies 18% 15-20%

B. Within the context of this policy statement, the term "alternative strategies" will generally apply to various hedging and financial arbitrage strategies as well as to high yield and non-rated fixed income securities. It is expected that, over time, these investments will out-perform traditional bond and stock securities while reducing the volatility of year-to-year results for the entire endowment.

C. Over a three to five year period: The common stock and investment grade bond portfolios will be expected to out-perform the Wilshire 5000 Stock index and the Lehman Aggregate Bond index, respectively, after fees. The aggregate endowment will be expected to out-perform a policy benchmark portfolio consisting of 65% Wilshire 5000 index and 35% Lehman Aggregate Bond index.

D. The risk of the aggregate endowment portfolio, as measured by annual standard deviation of return, will be less than the risk of the policy benchmark portfolio referenced above.

IV. PORTFOLIO QUALITY

A. Common stock purchases will be limited to marketable securities quoted on a major exchange or in the over-the-counter markets.

B. The limited use of derivative contracts is permitted, but only for hedging purposes or to create investment exposures that are consistent with the guidelines contained herein.
C. No investment that would generate unrelated business taxable income to the endowment will be permitted.

V. MANAGER SELECTION AND REPORTING

A. The Endowment Oversight and Finance Committees will be responsible for recommending managers and pooled investment vehicles for full Board approval.

B. With respect to pooled investment vehicles selected for the endowment, for which individual managers are selected by a third party, all such individual managers will be expected to comply with the relevant policies contained herein.

C. Investment managers (individual or pooled) will provide portfolio and performance updates not less than quarterly and will meet with the Endowment Oversight and/or Finance Committees not less than annually to review portfolio strategy and results.

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Author: Brad Cates, Business Manager, Pembroke Hill School, November 1997.