

Long-Term Management Funding



Costing, Funding, and Stewarding endowments for perpetual conservation of natural resource values

David Brunner / Center for Natural Lands Management / September 2011

What is an Endowment?

Assets managed to support an organization's mission over time

What is an Endowment?

- Charitable trust asset
- The corpus is permanently restricted and investment earnings are temporarily restricted
- Regulated and enforced by the Attorneys General and Treasury
- Subject to UPMIFA
- Restrictions can only be lifted by a court and are subject to the legal doctrine of cy pres

What isn't an Endowment?

Internally or Board restricted funds that are managed and invested like an endowment – “quasi-endowment”

Key Concept

Intergenerational Equity

“The trustees of
endowed institutions
are the guardians of
the future against the
claims of the present”

Nobel laureate James Tobin



Establishing Endowments

Rules of the Road



Key Concept

Get it right the first time – changing it later is hard

Establishing Endowments

Three Phases

- Costing - Investigation and identification of annualized managements costs (the PAR process)
- Funding - Investigation and establishment of asset allocation models and net investment yield curves responsive to short-, mid- and long-term risks (the Endowment process)
- Stewardship - Prudent (adaptive) management of the protected assets (the land and the endowment!)

Costing

Analysis and identification of annualized stewardship and organizational costs necessary to assure that the conservation values are protected and maintained in perpetuity

Costing

Sets the threshold for
intergenerational equity
and endowment funding

Key Concept

Costing

PAR software is a tool to assist with this process – but as with all software GIGO applies

Key Concept

Costing

Types of line items to consider – this is not intended to be a PAR training!

- Project Status - Fee holder, CE holder, project proponent and business risk, boundaries and ownership, permits and regulations...
- Species Requirements - Protected species present, monitoring needs, predator control, habitat manipulations...
- Habitat Requirements – Wetlands and acreage, manipulations (flooding, fire, irrigation) and permits, invasive controls, perimeter security...
- Habitat Restoration – responsibilities, assumption of management, success criteria...
- Division of Responsibilities – Fuels management zones, manufactured slopes, trails and recreation, water conveyance...

Costing

Types of line items to consider – this is not intended to be a PAR training!

- Special Districts and Fees - often not included in title reports, review current tax bills...
- Reporting Requirements – Periodicity, number, audience...
- Neighboring Uses – Current, probable and possible, local opposition, enforcement...
- Water Concerns – sources, reliability, possibility of contamination, costs...
- Pitfalls – Assumptions without data, price variability, price uncertainty, incomplete project information or requirements...

Costing RISKS

- Too Little - Failure is very likely and remedies are difficult and costly (TET)
- Too Much – Waists scarce financial resources, creates legal headaches and costs, risks reputational and political damage
- Incomplete - failure to budget sufficient support for organizational expenses (overhead), to anticipate contingencies and stochastic events, and to provide for legal support will undermine long-term success

Funding

What should the value of the endowment be (in both permanently and temporarily restricted funds) in order to support the annualized stewardship and organizational costs and achieve intergenerational equity?

The importance of initial conditions

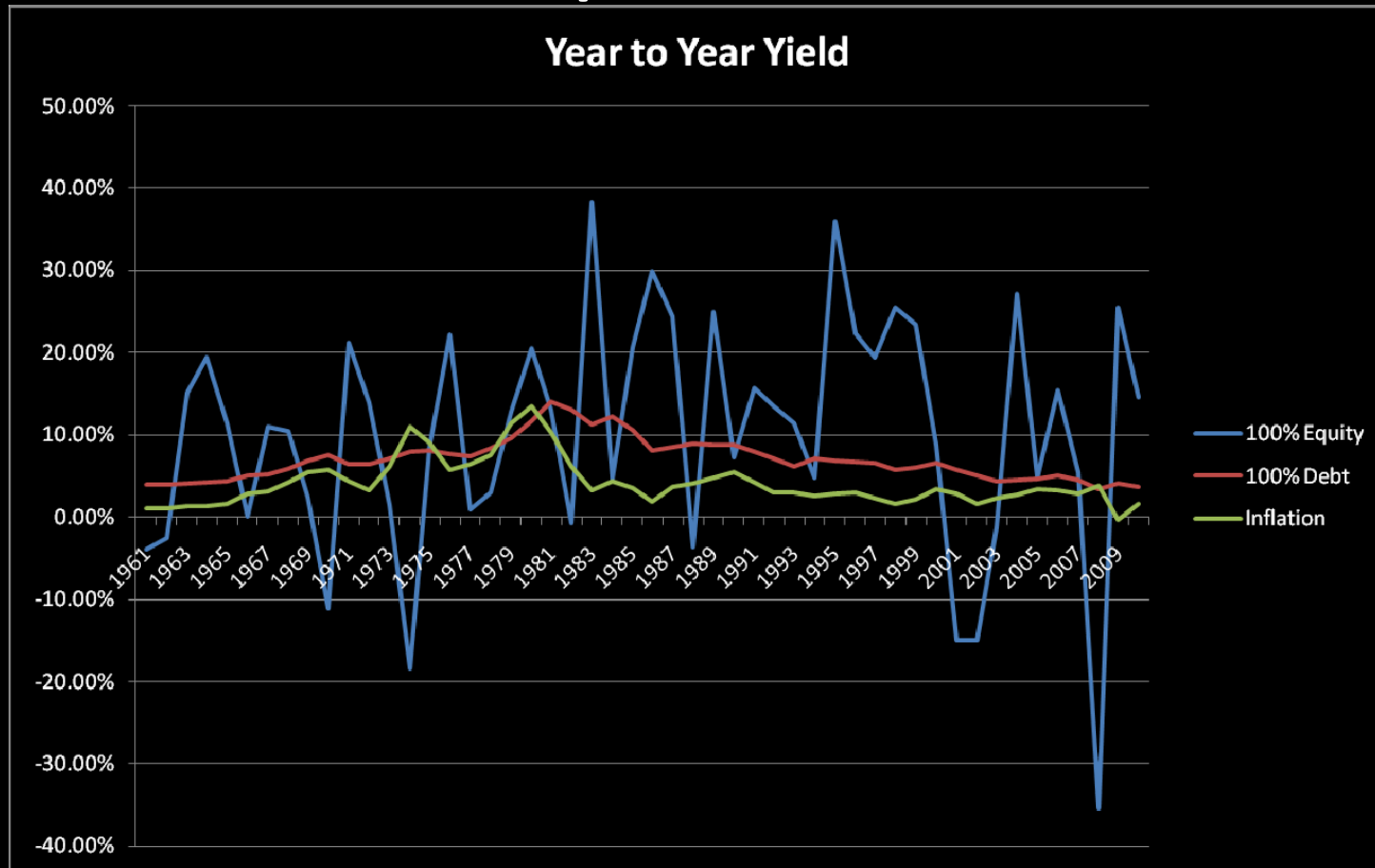


How asset allocation, spend rules, and starting market conditions have big impacts on future endowment

What is portfolio risk?

risk = uncertainty of investment income = volatility

What is portfolio risk?

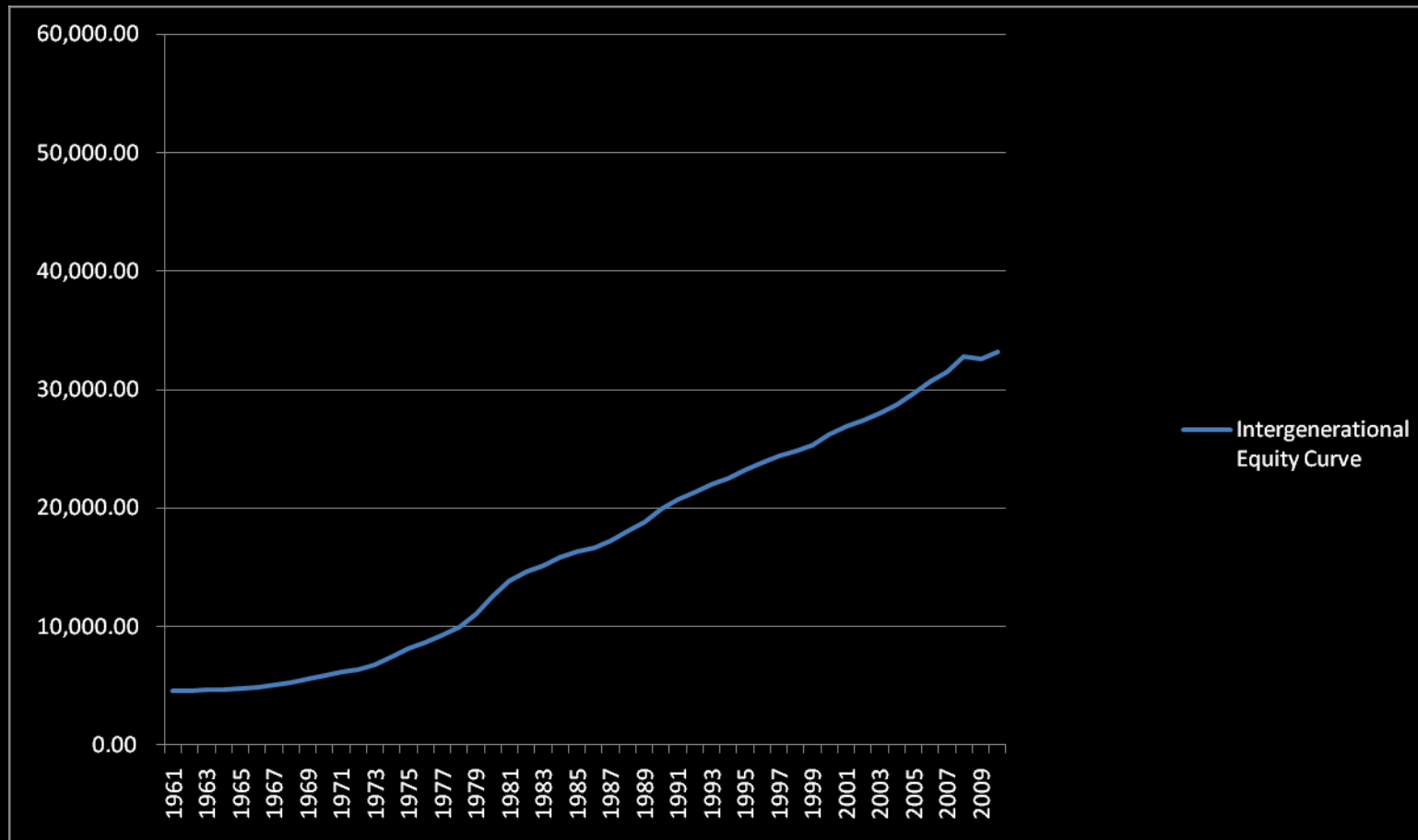


This is a picture of volatility

A diversified investment portfolio provides higher returns over time with less volatility than one in which only a few investment types are used

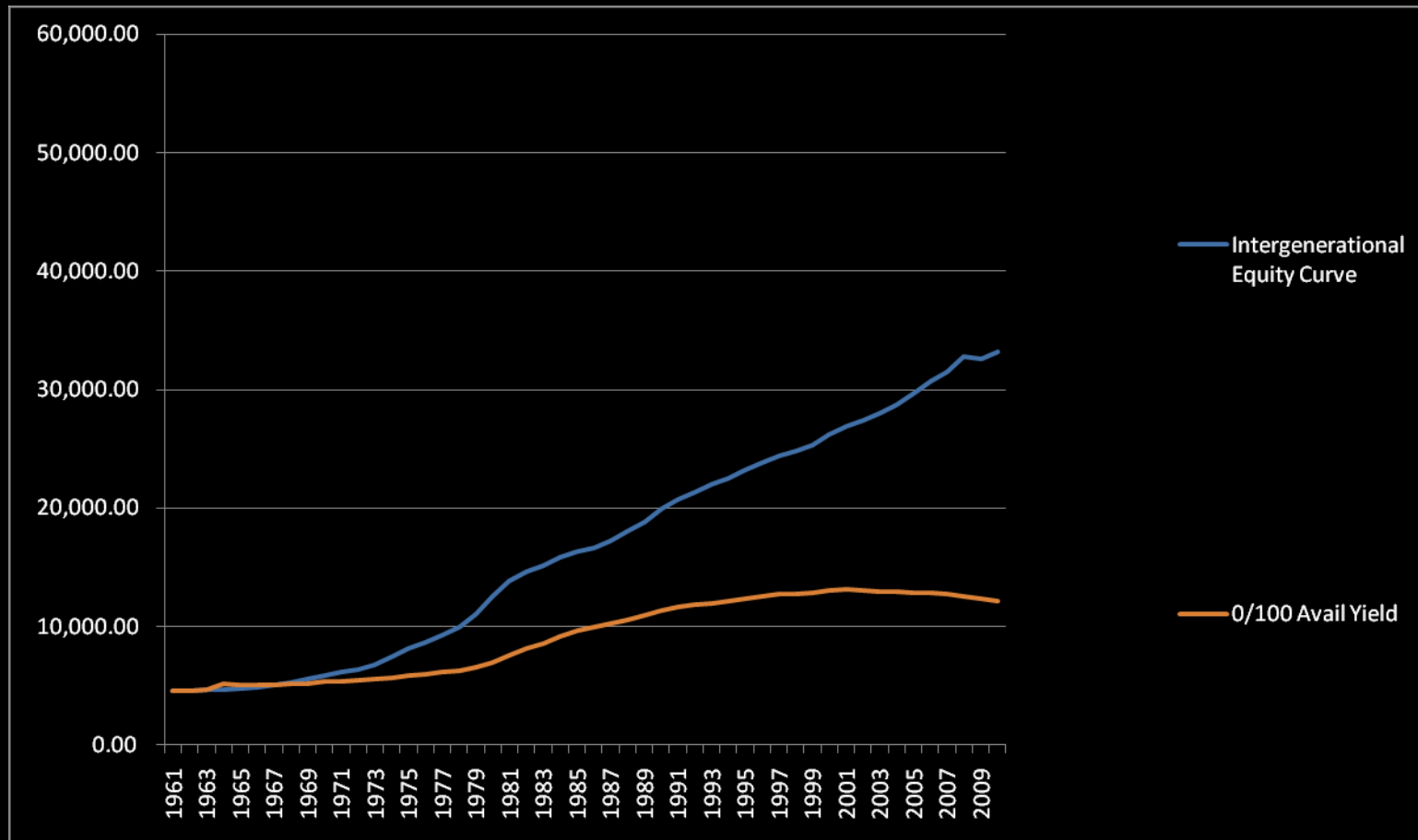
Key Concept

The effects of asset allocation



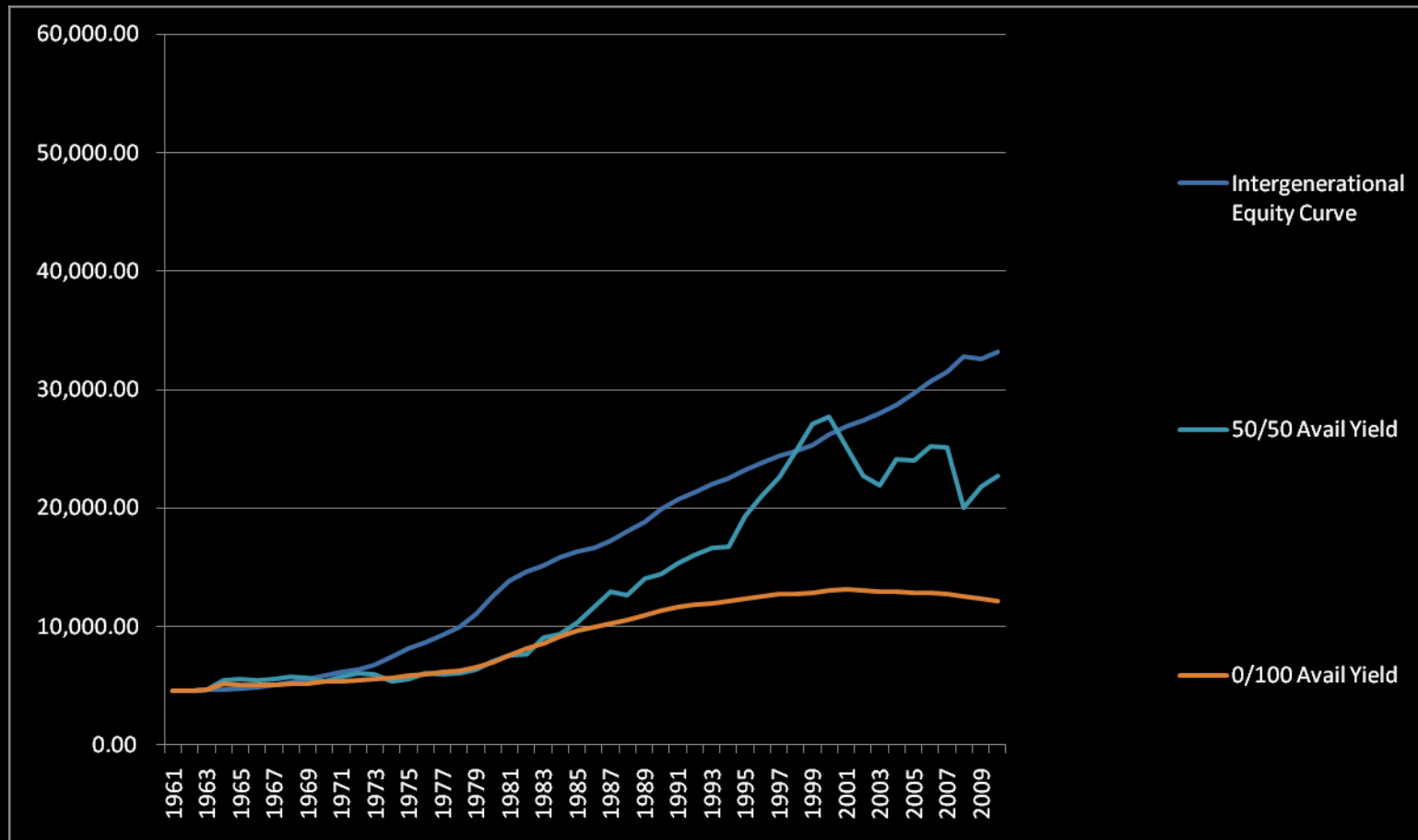
First our available yield goal –
the Intergenerational Equity Curve

The effects of asset allocation



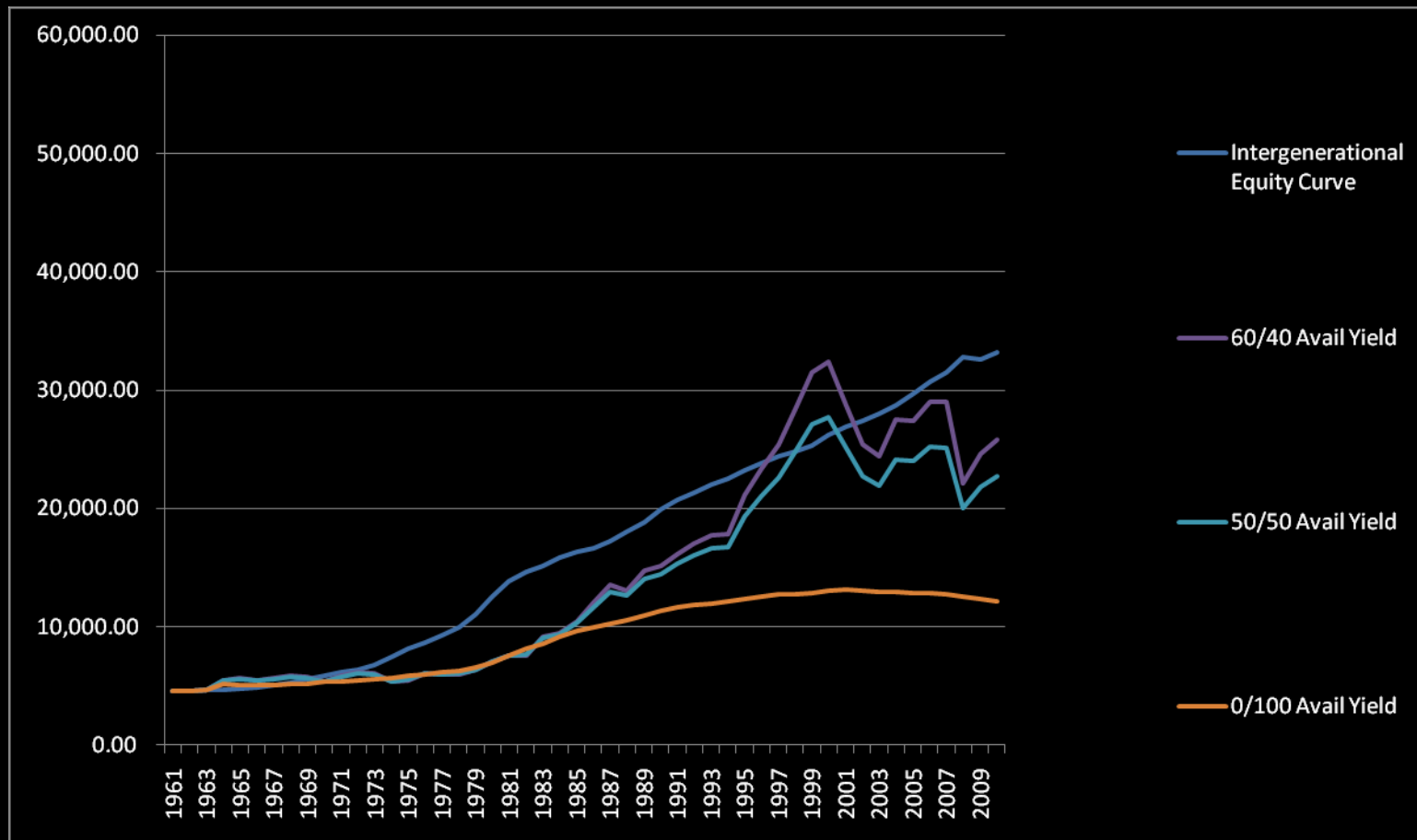
The endowment mission is only fully served when the available yield is equal to or greater than the intergenerational equity curve

The effects of asset allocation



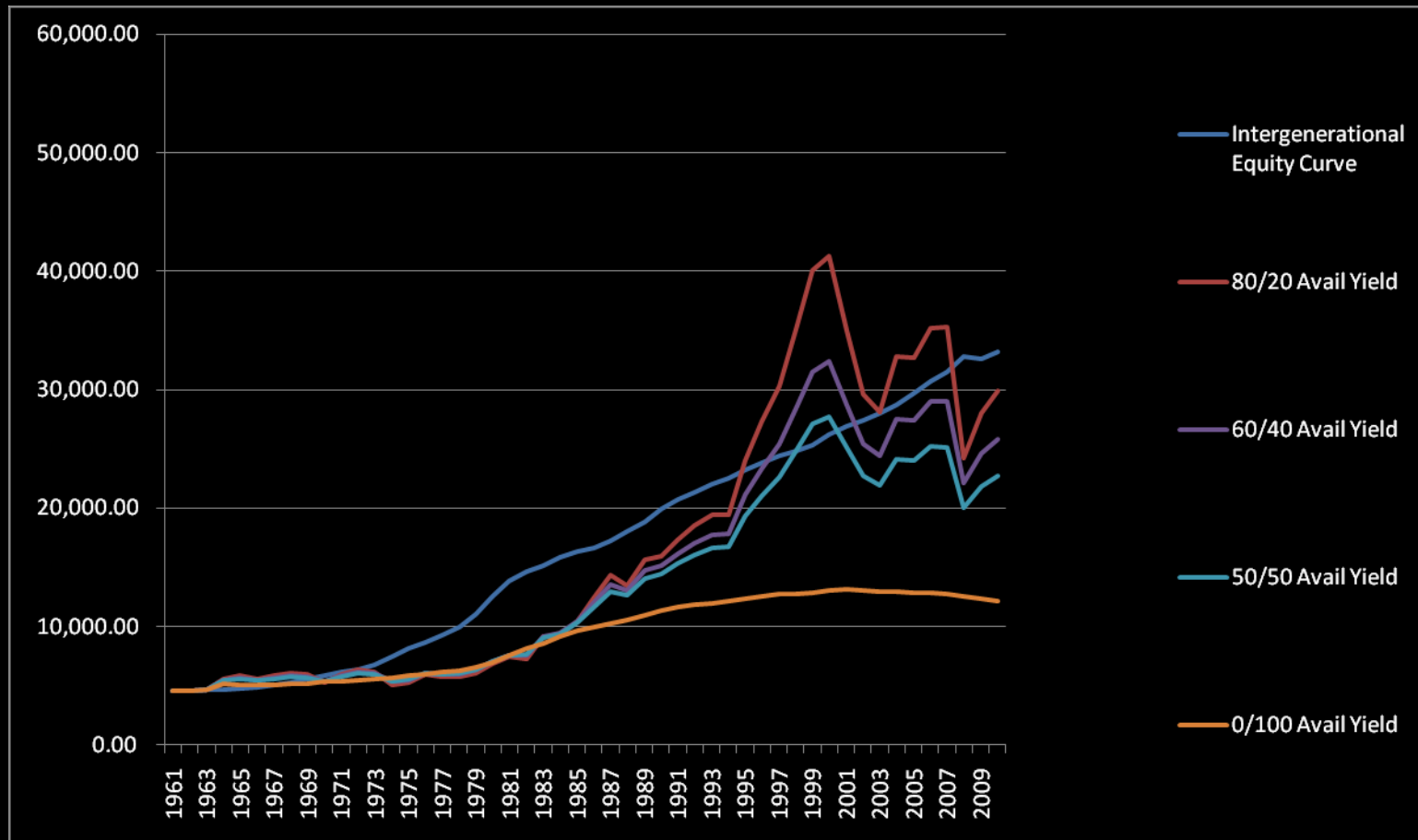
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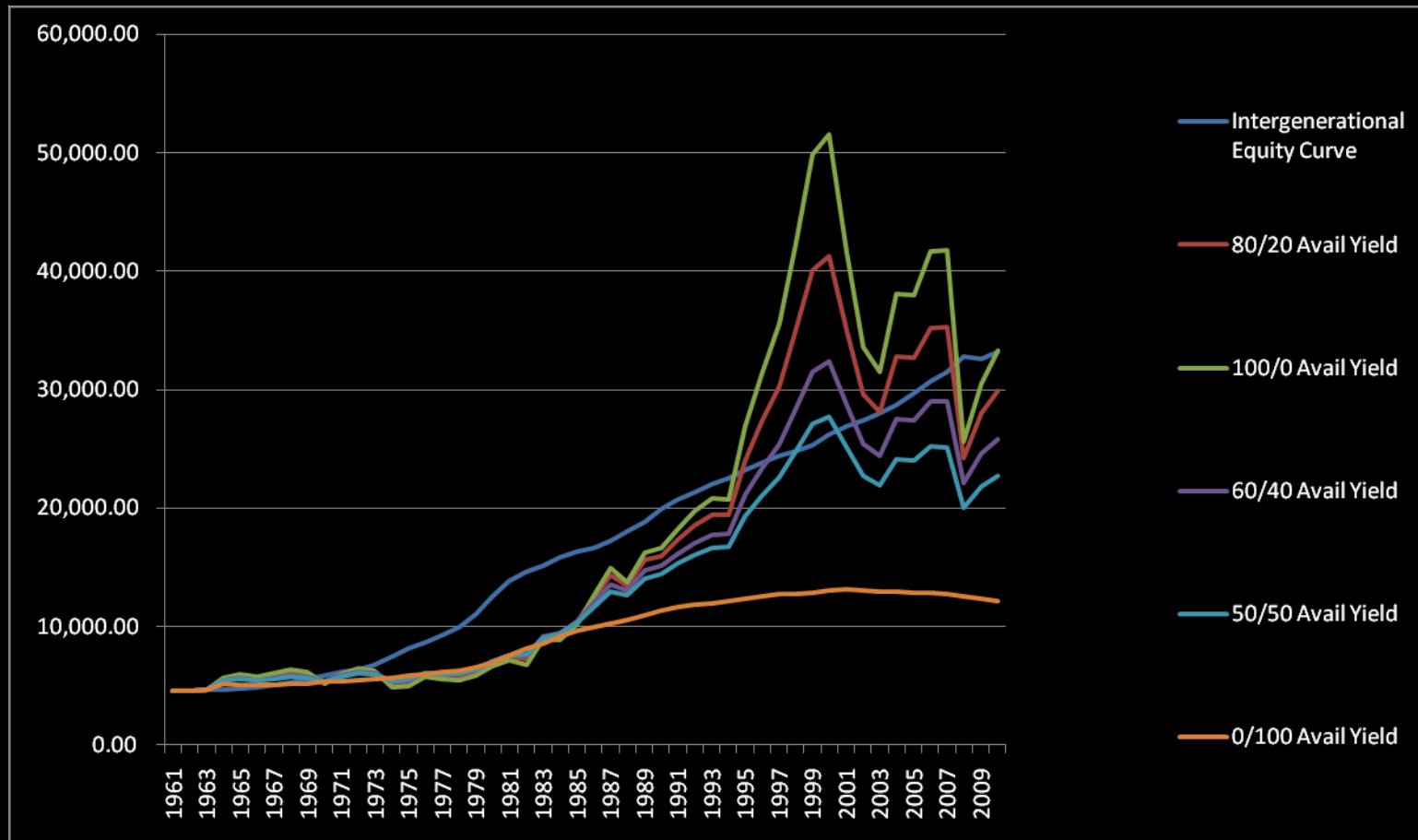
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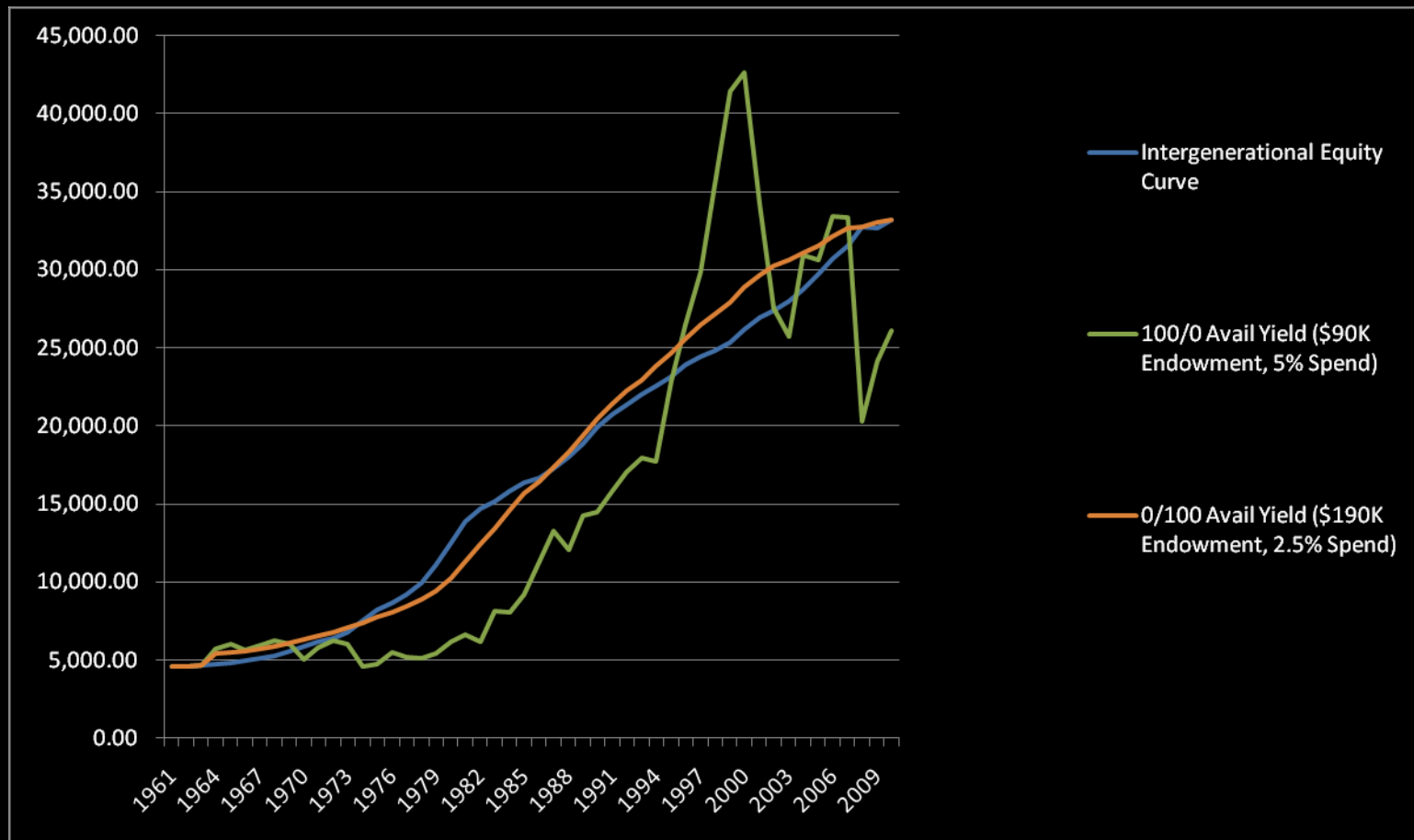
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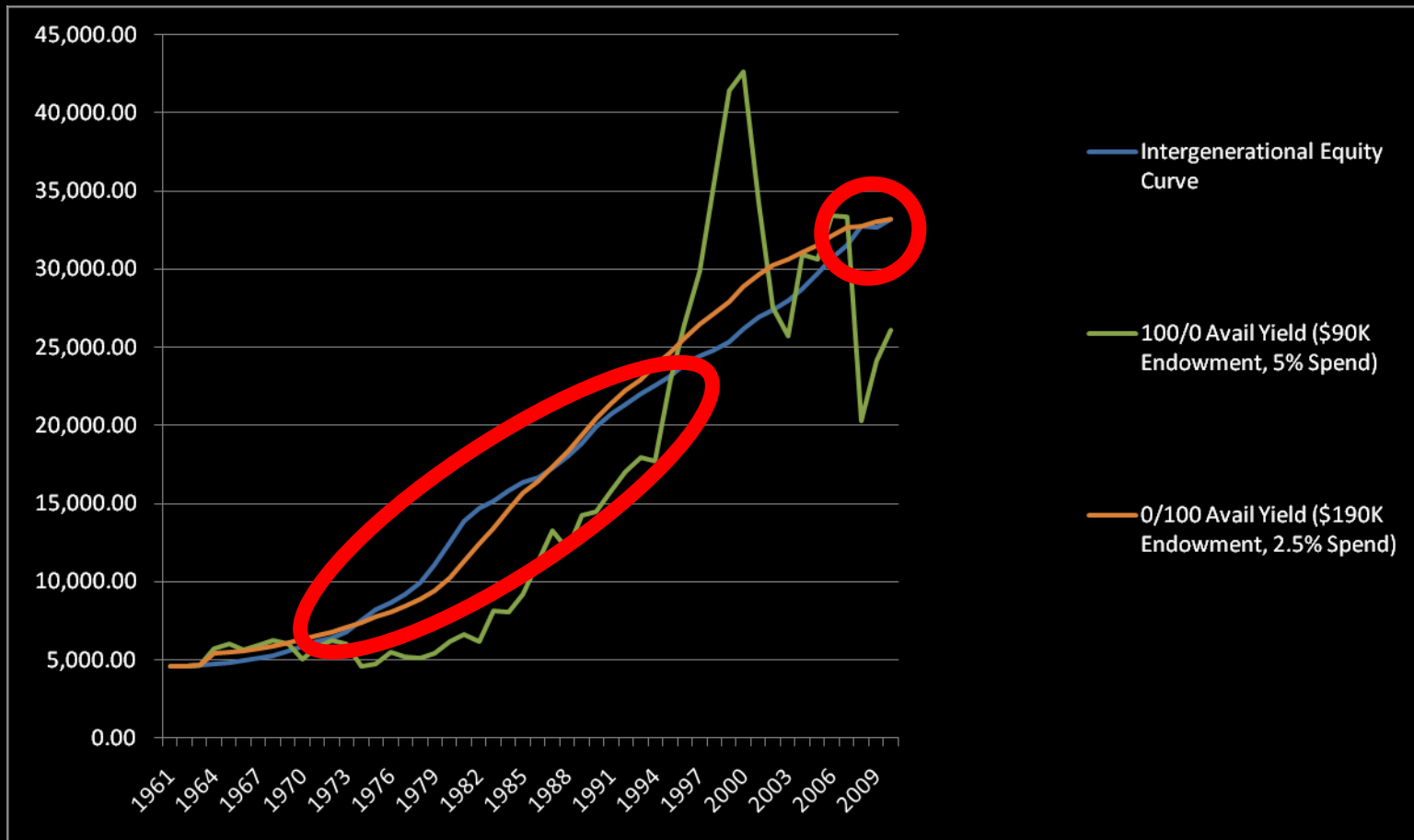
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The effects of asset allocation



The principal drivers of endowment corpus needs are asset allocation and spend rules

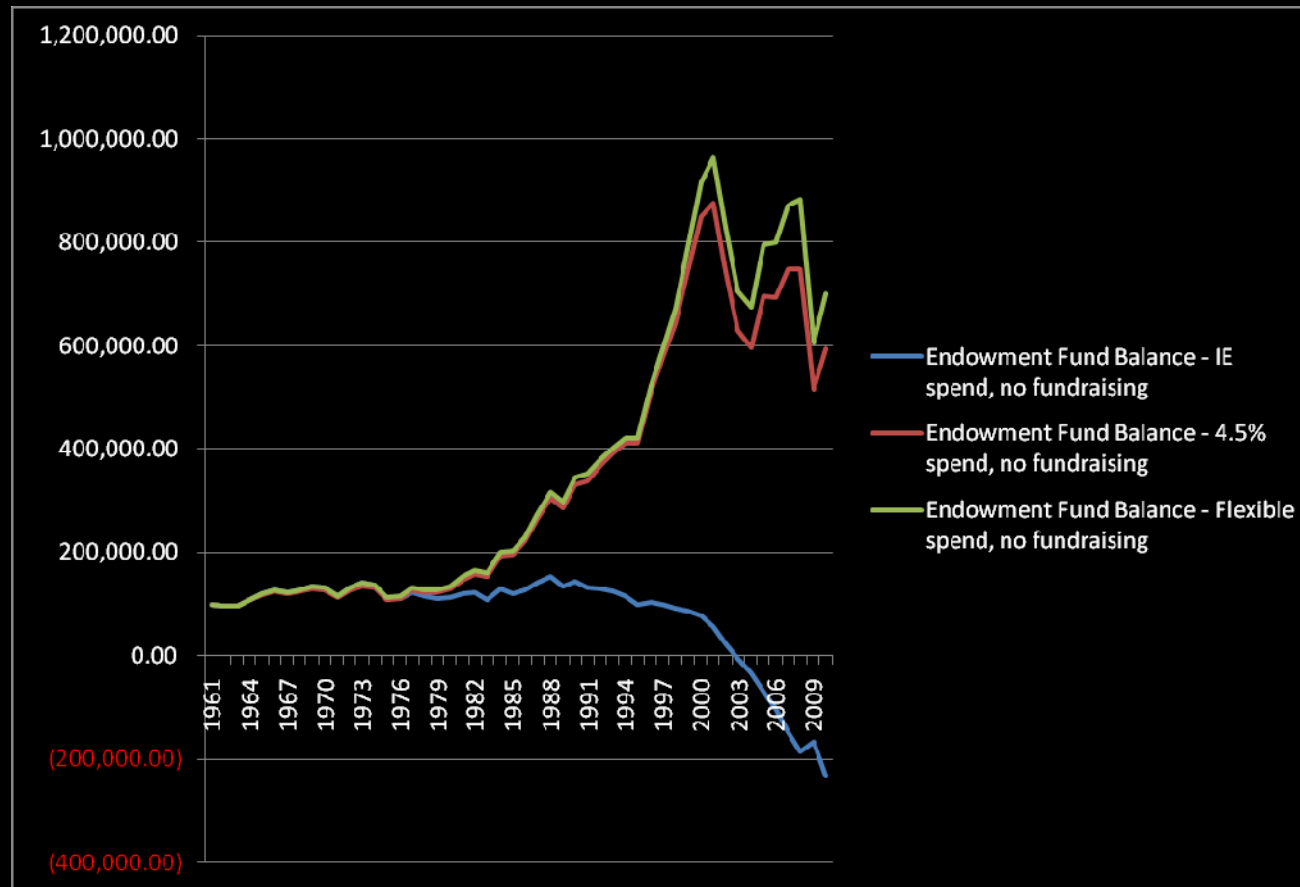
Intergenerational Equity – you just can't get there from here



Chasing Intergenerational Equity

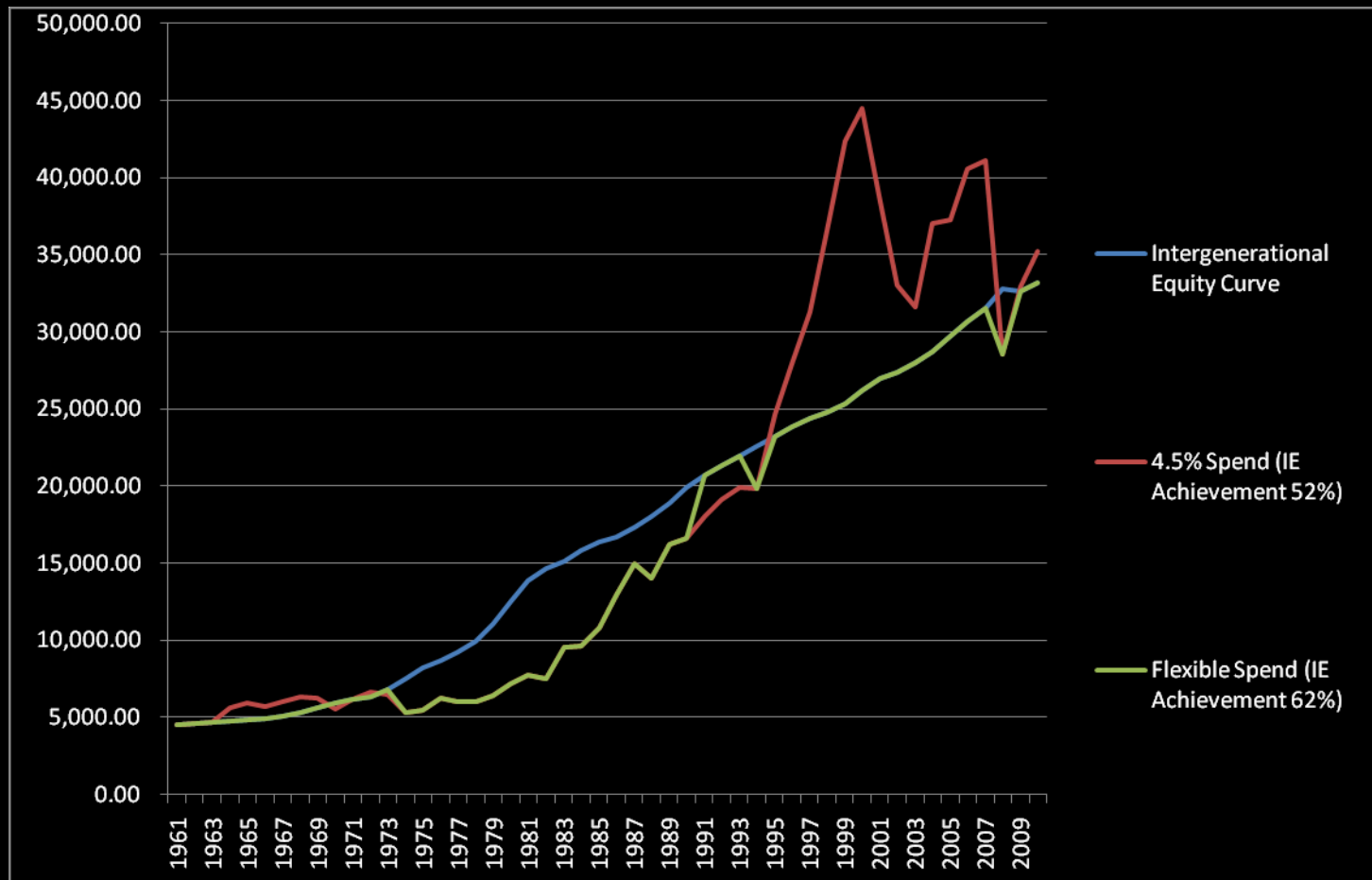


Chasing Intergenerational Equity



The impact of spend rules on
endowment performance

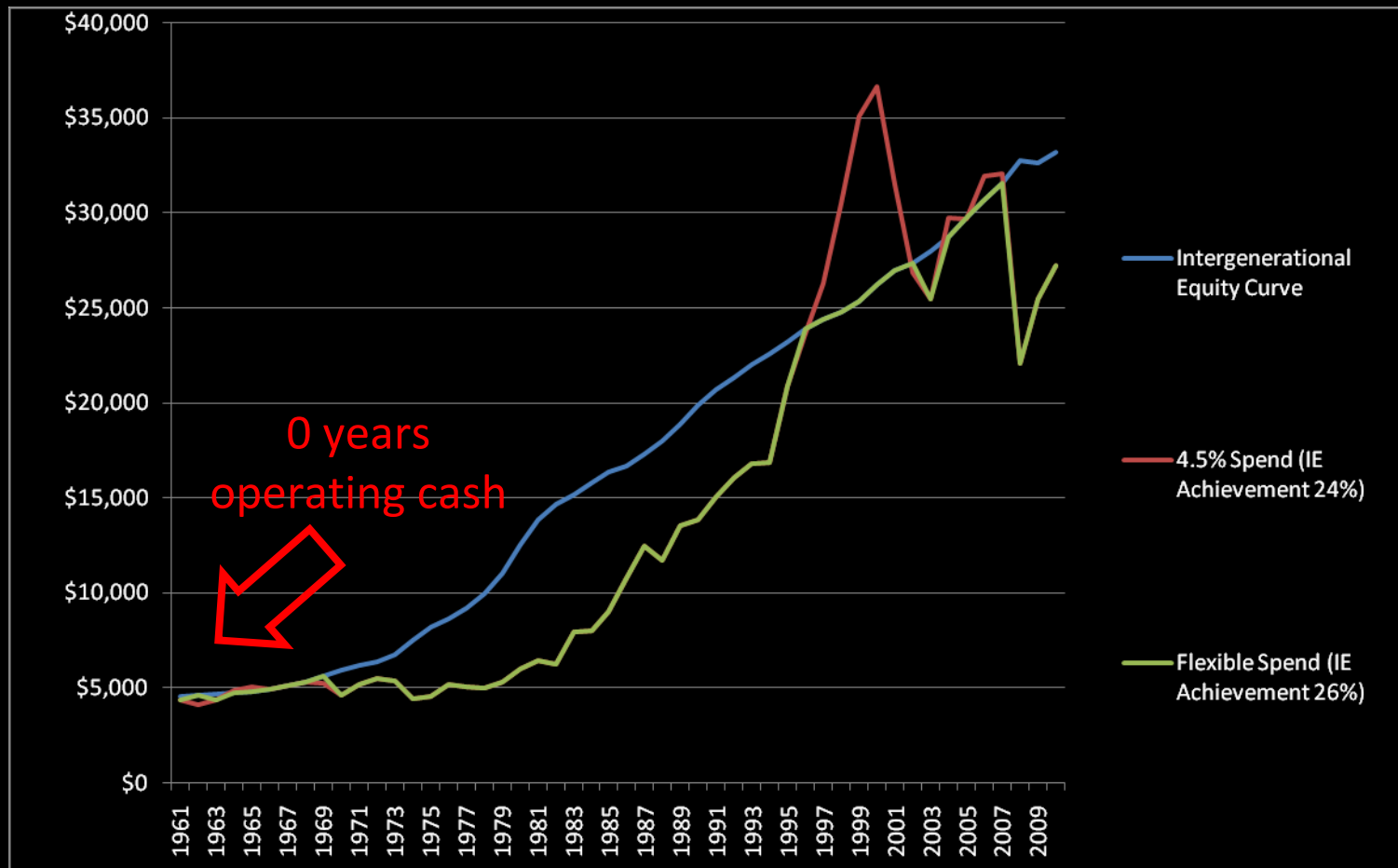
Chasing Intergenerational Equity



The impact of spend rules on endowment performance

Key Concept

Chasing Intergenerational Equity



The impact of early market performance and upfront temp restricted assets on endowment performance

Key Concept

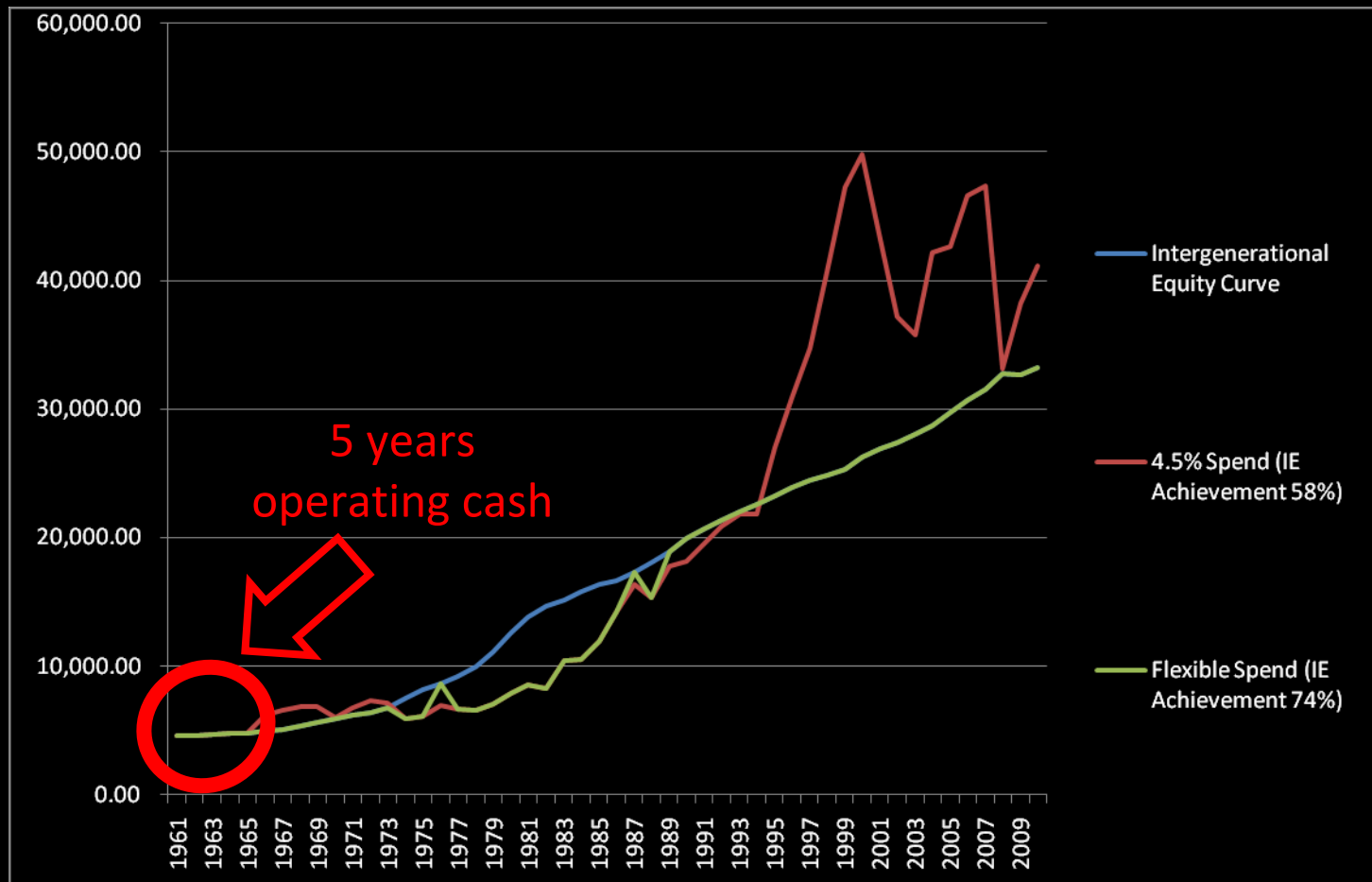
Chasing Intergenerational Equity



The impact of early market performance and upfront temp restricted assets on endowment performance

Key Concept

Chasing Intergenerational Equity



The impact of early market performance and upfront temp restricted assets on endowment performance

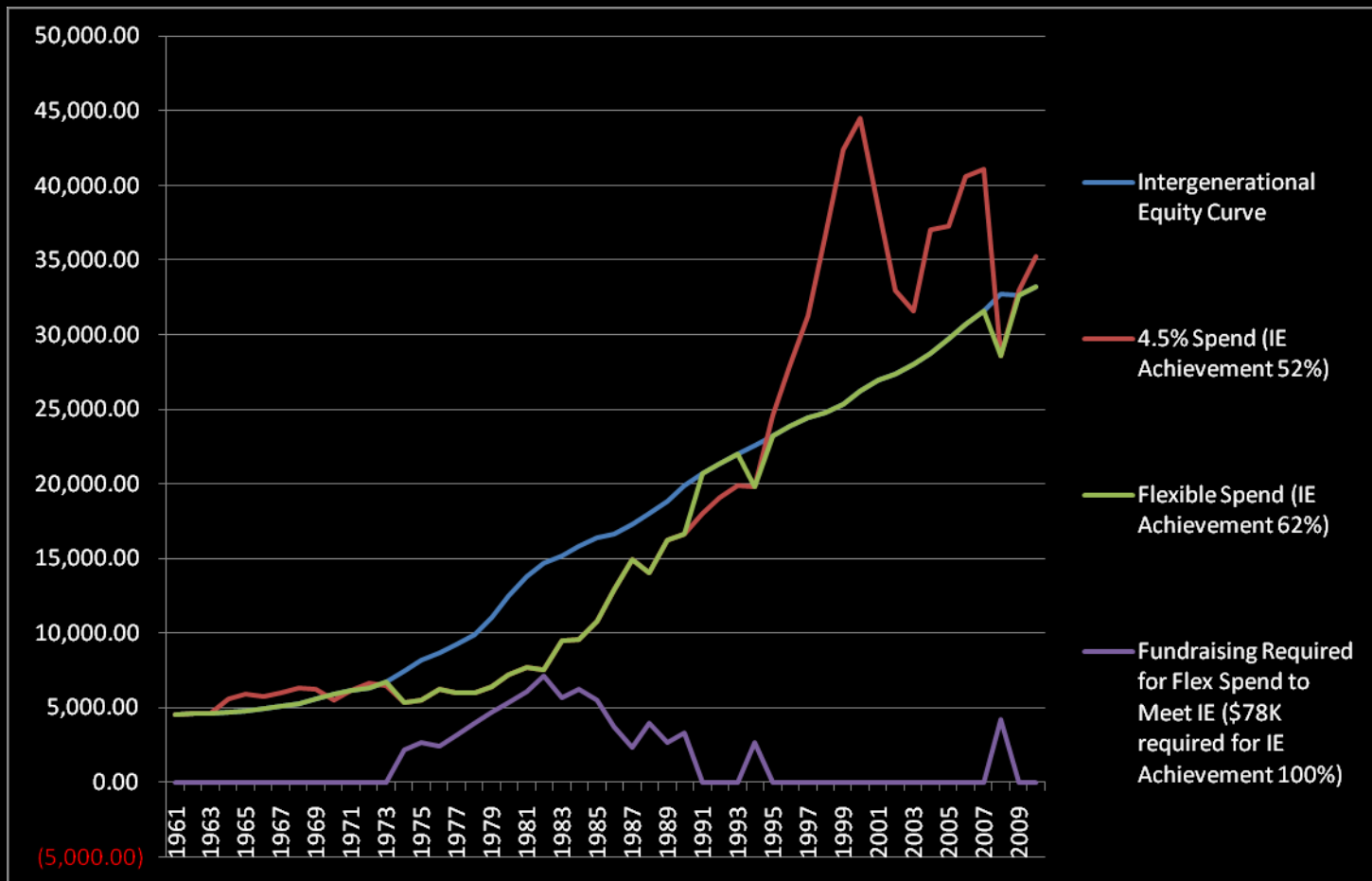
Funding Intergenerational Equity



Key Concept

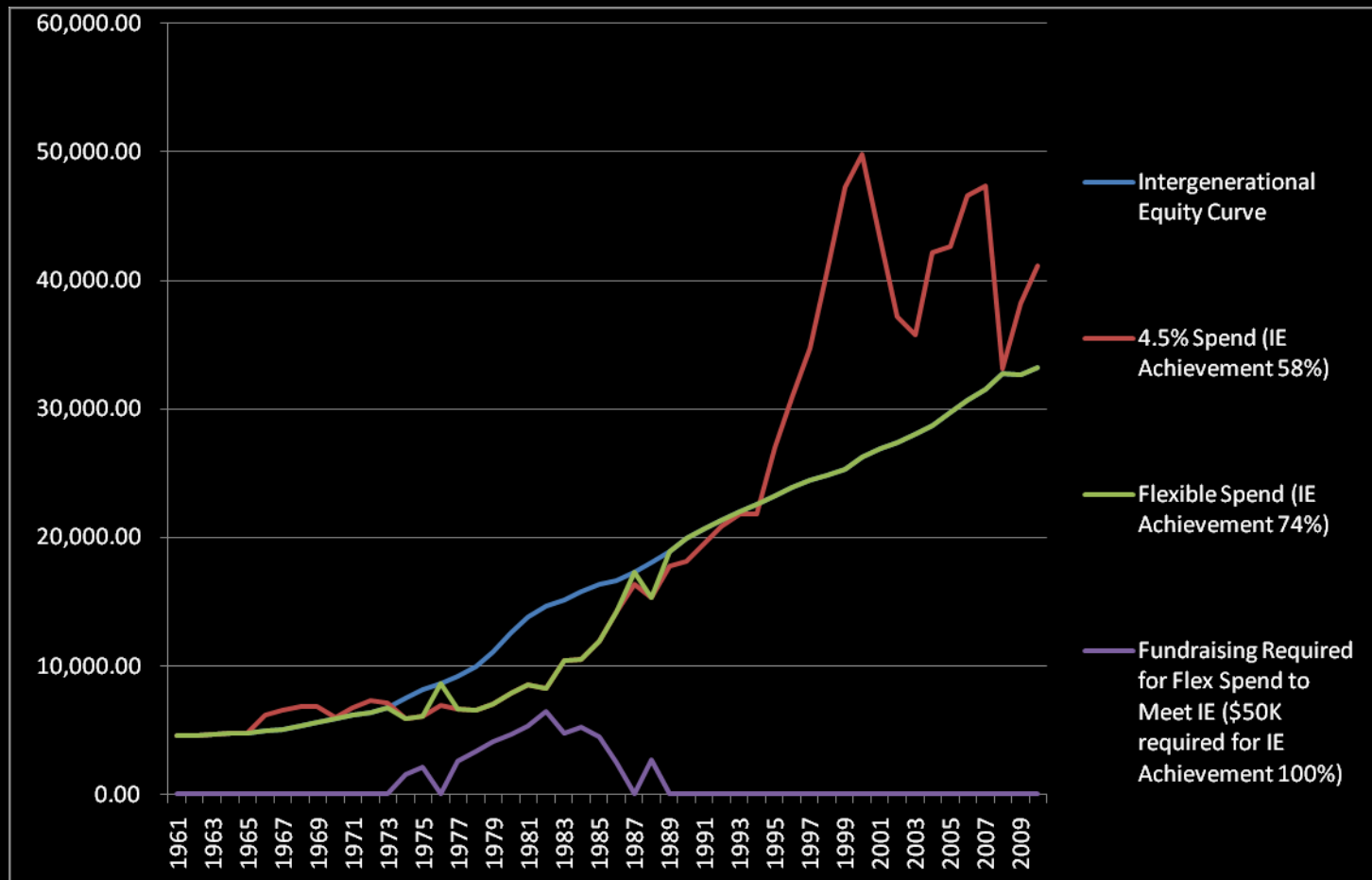
Fundraising is the only sure way to future endowment success –
starting conditions will dictate how much will be required

Funding Intergenerational Equity



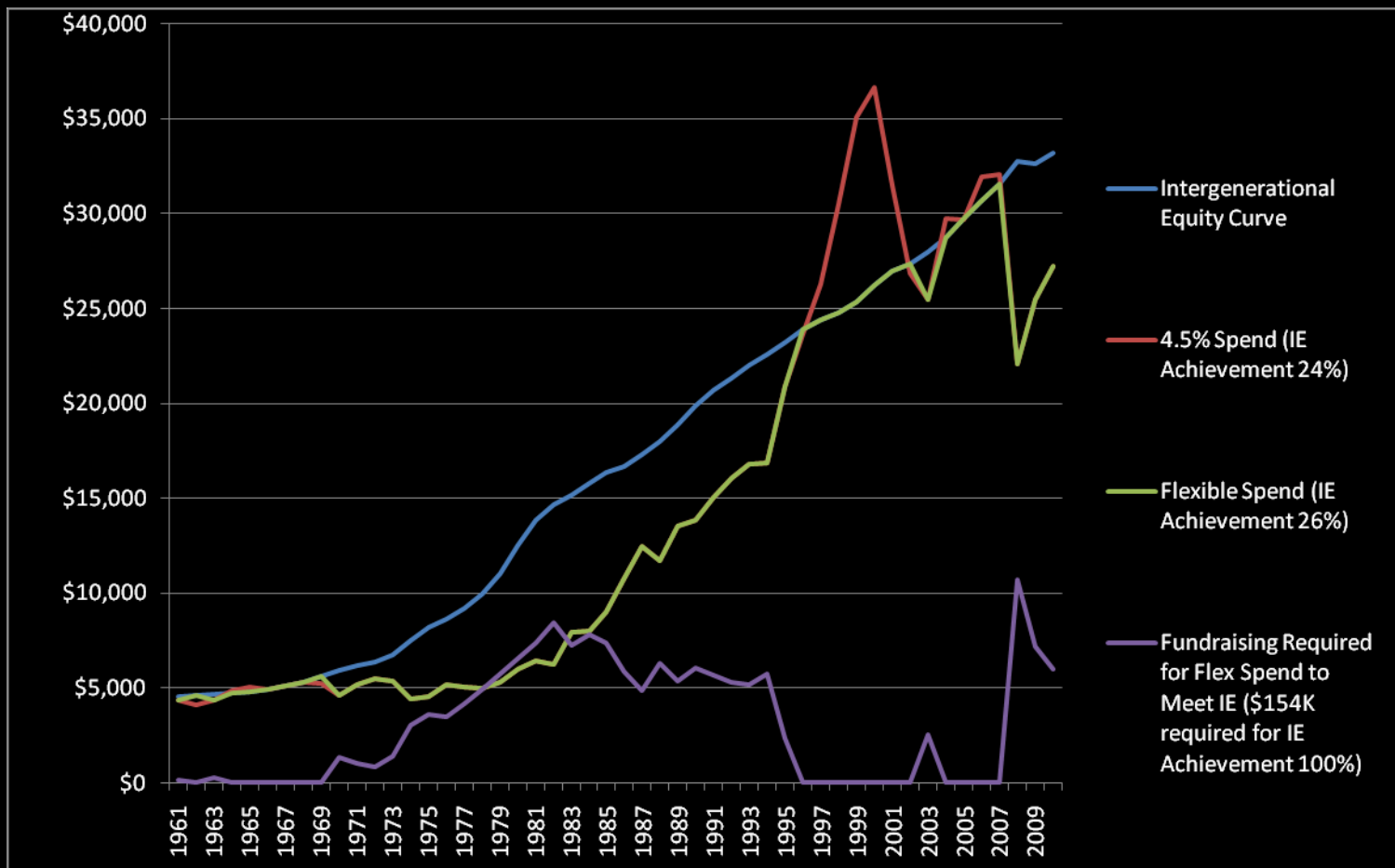
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Funding Intergenerational Equity



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Funding Intergenerational Equity



Fundraising is the only sure way to future endowment success – starting conditions will dictate how much will be required

Allocation Planning



" The future ain't what it used to be."

Yogi Berra

Allocation Planning

Allocation planning focuses on portfolio risk management

It must consider:

- strategy

- liquidity

- balance sheet

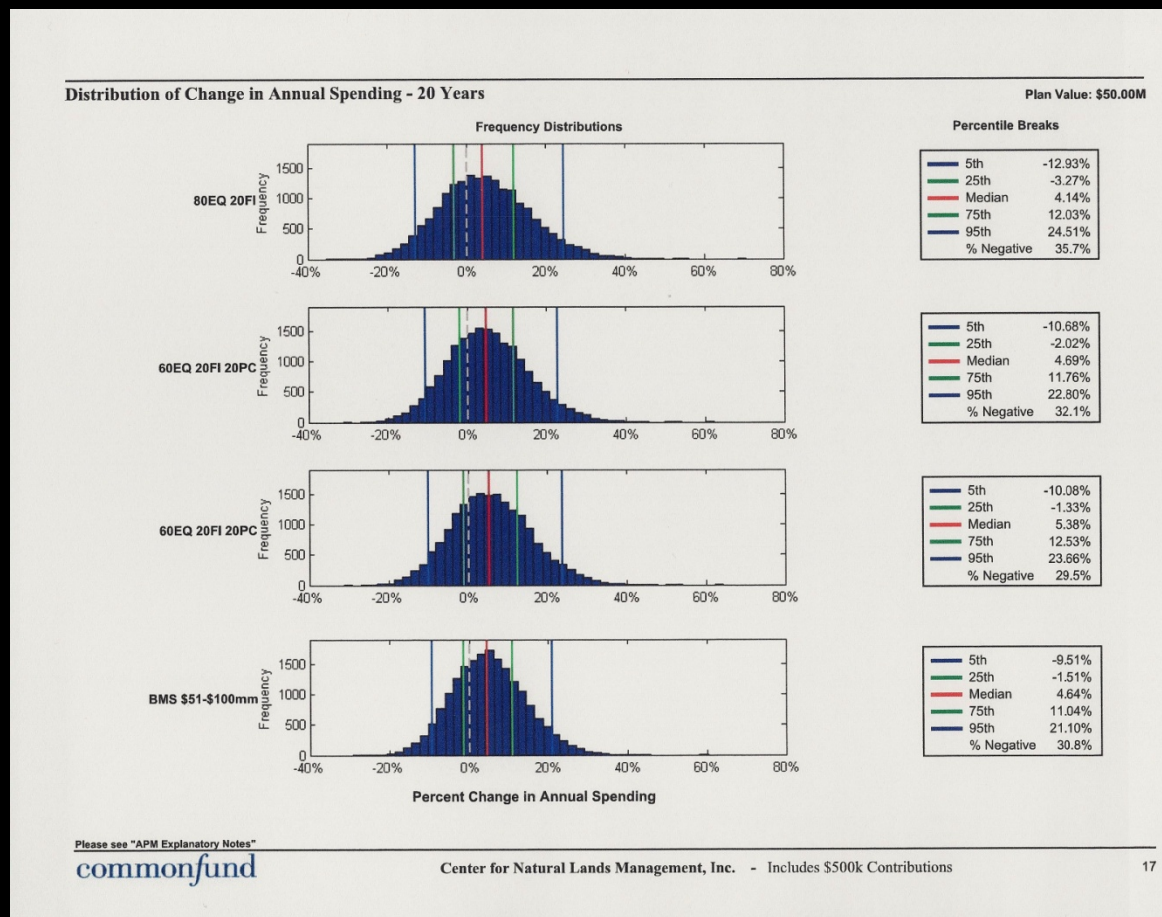
- credit

- operational risk

- reputation risk

Contemporary endowment management treats these as dependant and interrelated

Allocation Planning



Simulation algorithms can generate the probabilities of different possible outcomes of an investment strategy

Allocation Planning

APM - Generated Probability of Achieving Intergenerational Equity (CPI)

Plan Value: \$50.00M

	80EQ 20FI	60EQ 20FI 20PC	60EQ 20FI 20PC	BMS \$51-\$100mm
Probability				
5 Years	84.70%	89.90%	93.00%	90.60%
10 Years	69.70%	80.60%	86.40%	81.00%
15 Years	70.10%	79.00%	87.10%	81.40%
20 Years	67.40%	76.80%	85.50%	79.10%
Asset Summary				
Equity Strategies	69.20%	72.42%	72.42%	55.66%
Fixed Income Strategies	17.92%	17.92%	17.92%	28.00%
Directional/Relative Value	12.88%	9.66%	9.66%	12.54%
Real Assets	0.00%	0.00%	0.00%	3.80%
Asset Mix				
Equity/Fixed	81% / 19%	81% / 19%	81% / 19%	65% / 35%
Spending Rule	Percent of Market Value	Percent of Market Value	Percent of Market Value	Percent of Market Value
Schedule	No additional Spending planned over 20 years	No additional Spending planned over 20 years	No additional Spending planned over 20 years	No additional Spending planned over 20 years
Contributions Rule	None	None	Growth Initial contribution of \$0.5 with a growth rate of 0%. Contribution rate calculated over 1 annual period average and drawn annually.	Growth Initial contribution of \$0.5 with a growth rate of 0%. Contribution rate calculated over 1 annual period average and drawn
Schedule	No additional Contribution planned over 20 years	No additional Contribution planned over 20 years	No additional Contribution planned over 20 years	No additional Contribution planned over 20 years

Please see "APM Explanatory Notes"

commonfund

Center for Natural Lands Management, Inc. - Includes \$500k Contributions

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Simulation algorithms can generate the probabilities of different possible outcomes of an investment strategy

Funding

Once asset allocations have been modeled and decisions made and the optimal amount of initial temporarily restricted operating cash has been set the initial value of the endowment can be determined

Funding

Determining the initial endowment value

(50 year average of real returns by asset class as a percentage of balance) less (50 year average of actual CPI as a percentage of total costs) = IE Adjusted Yield (aka – Cap Rate)

(Annualized Stewardship and Operational Costs – from Costing Phase) / IE Adjusted Yield = endowment corpus (the permanently restricted value)

Funding

Determining the initial endowment value

(permanently restricted endowment corpus) plus
(initial temporarily restricted operating cash
required) = initial endowment value

Funding

Developing a prudent Spend Rule

Key Concept

The “Cap Rate” is not a prudent Spend Rule!

A prudent Spend Rule is flexible and responsive to the requirements of intergenerational equity!

Such a flexible Spend Rule might be – the CPI adjusted Annualized Stewardship and Operational Costs or the “Cap Rate” whichever is less

Funding RISKS

- Default - Failure of the Project Proponent to fully fund the endowment will leave the steward of the conserved land with a permanent obligation that is unsupported financially (Standing Letter of Credit)
- Delay – Failure of the Project Proponent to fund the endowment in a timely manner will reduce anticipated investment earnings and undermine Funding Phase planning decisions (Lost or foregone yields must be recovered!)

Stewardship

Prudent (adaptive) management of the protected assets (the land and the endowment!) in perpetuity

Stewardship

Fiduciary obligations and institutional risk



"There is an immeasurable distance between late and too late."

Augustine "Og" Mandino II

Stewardship

Develop and implement a corporate policy for investment and use of restricted assets

Purpose

Investment objective

Asset allocation

Spend rule

Manager selection and review

Roles and responsibilities

Accountancy oversight

Stewardship

Discuss at board meetings how restricted assets are being used and protected and reflect those discussions in meeting minutes

Stewardship

Put in place accounting systems that adequately record and report the use of restricted assets

Stewardship

Establish internal controls to prevent commingling restricted and unrestricted assets as well as assets with differing restrictions

Stewardship

Make inquiries into questionable conduct and exercise general oversight to determine whether anything might be questionable

Stewardship

Assure that the endowment is managed in such a way as to provide a revenue stream for stewardship of the land that meets the objectives of intergenerational equity.

Key Concept

A “healthy” endowment paired with unhealthy habitats or vice versa is failure!

Stewardship

Anticipate the unexpected – in both management of the endowment and management of the land

Key Concept

Plan for contingencies and stochastic events!

Stewardship

RISKS

- Oversight Failure – Endowments and preserved habitats have long time frames, with good oversight problems will be detected in time to react and correct them
- Complacency – to quote Eisenhower “Planning is everything, the plan is nothing”
- Exuberance - cultivate your curmudgeon – just because things are going well now does not mean they wont go badly later

Stewardship



So now, go forth and walk on water!

And always remember...

"Laws Change;

people die;

the land remains."

Abraham Lincoln