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<i>FINANCIAL POLICY AND PROCEDURES</i>		<i>Instruction Number:</i>
<i>Subject:</i> INVESTMENT MANAGEMENT		<i>Date Issued:</i> 23 January 1990
<i>Title:</i> ENDOWMENT MANAGEMENT POLICY		<i>Date Revised:</i>
<i>Issued by:</i> V.P. Finance & Administration	<i>Approved by:</i> Board of Governors 23 January 1990	

SUBJECT: INVESTMENT MANAGEMENT
TITLE: ENDOWMENT MANAGEMENT POLICY

INTRODUCTION

The University's core education programming is funded primarily from public (i.e. government) and user (i.e. student) sources. Enrichment activities - those which allow us to pursue excellence - must seek funding from non-core sources; clearly, the principal such source is and will continue to be University endowments.

Dalhousie's longer term financial strategy calls for more aggressive and more ambitious Development activities. By request of the donors and by the predisposition of the University, much of the proceeds of such Development initiatives should be targeted toward more and larger endowments. In fact, efforts should be made to convince the provincial government to establish a matching funds program in connection with new University endowments; the federal government (through its NSERC matching grants program) and a number of other provincial governments (notably Alberta and B.C.) have shown the way in this regard by encouraging and enhancing private sector support for post-secondary education.

Endowment management, both financial and administrative, may be just as important as endowment giving to the future health of Dalhousie University. Existing endowments are valued at approximately \$110 million. Careful and prudent management can ensure that this great asset continues to support the pursuit of excellence indefinitely, and itself can serve to attract additional endowment gifts.

The following outline for endowment fund management addresses structure, objectives, and administrative policies. It does not deal with the management of expenditures but rather with the management of capital and income over time. The fundamentals involved are consistent with those adopted by other universities with significant endowments (e.g. Alberta, McGill, Toronto, Harvard), but Dalhousie's own traditions and requirements have shaped the details.

DEFINITIONS

1. Regular Endowment Fund: monies accepted from second parties with concurrent fiduciary responsibility; the time frame may be perpetual (true endowment) or for a specified period (term endowment).
2. Self Endowment Fund: as above, except that monies are placed in endowment by choice of the

University rather than obligation. The time frame may be conceived as being perpetual or for a specified period, but remains within the discretion of the Board of Governors.

3. Constrained Endowment Fund: as in #1 above, except that additional financial management constraints may be agreed upon acceptance of the endowment monies. (Example: no tobacco-related investments).
4. Special Arrangements Endowment Fund: as above, but with special/unique provisions, usually for an agreed period of time. (Example: an endowment donor might agree to shorter-term reductions of principal as long as longer-term replenishment is assured).

PREMISES

The fundamental premise of this management policy is that fiduciary responsibility is for the real (purchasing power) value permanence of endowments; this proposal rejects nominal (ignoring inflation) value as the basis for financial management of Dalhousie's endowment funds.

A corollary premise is that endowment growth is within the scope of endowment fiduciary responsibility; however, dissipation of principal (by inflation or otherwise) is not responsible unless by explicit agreement of the endowment donor. The growth of an endowment can be the financial basis for future program enrichment and adaptation.

FINANCIAL OBJECTIVES

1. That a sustained, high profile fund development program be an integral component of University activities.

Prior to the early 1980's, Dalhousie had been relatively passive about fund development, though there were important and impressive exceptions to this observation. The launching and successful completion of the ambitious "Campaign for Dalhousie", the rapidly growing success of Annual Fund campaigns, and the recent initiation of a comprehensive review of future Development capacity, all of which were buttressed by the infusion of budgetary and other resources, display a fundamental commitment to this objective.

2. That long-term real returns to Dalhousie endowments be maximized.

The first imperative is to offset inflation erosion of endowment fund purchasing power. Maximum returns, with a longer-term view to take risks into account, result in greater cash flow for annual distribution, growth, and/or fluctuations reserves. Because of the greater financial returns achievable through the use of large investment pools (as opposed to large numbers of relatively small funds), Dalhousie recently has implemented "unitization" of its endowment funds. Large pools have been established (for equities, bonds, mortgages, and U.S. and global investments) in which each endowment fund may participate; the concept is similar to that of a mutual fund. Participation in U.S. and other foreign markets can enhance returns and reduce risk through diversification. Use of multiple (competing) investment counselling firms also can assist in maximizing returns.

3. That provision be made for longer-term future growth while protecting against shorter-term market fluctuations.

Beyond the actions to maintain purchasing power a balanced allocation of returns (net of inflation) is essential. It is important for University academic and scholarship program administrators to be assured of a level of minimum funding support for a rolling period of years (perhaps three). Yet it is desirable that future funding for growth and dynamic change be assured. Finally, investment returns will fluctuate; thus, a stabilization reserve is needed; further detail is provided later.

MANAGEMENT PRINCIPLES

1. Endowment management should be capable of assuring donors that endowment gifts will maintain or increase purchasing power over time.

Endowment donors are entitled (unless explicit provision is made for an alternative approach, as in the case of term endowments) to the assurance that the original purchasing power will not wither away over time. While protection against liquidation decisions and poor management is essential, the primary culprit is inflation. Over the nine-year period from 1979/80 to 1988/89, the purchasing power of Dalhousie's endowments has declined by about 15%. Unless compensating actions are taken, spending total interest income means gradual liquidation of capital and resultant dissipation of endowment purchasing power. It is vital that past and potential endowment donors feel an assurance that full protection is being provided systematically. Although the Consumer Price Index (CPI) may overestimate inflation somewhat, full CPI-based compensation for inflation should provide the necessary level of assurance to donors. To the extent that there is inflation overcompensation, there is the positive attribute of endowment expansion and resulting higher future income levels for program support.

2. Endowment management should ensure that there will be resources for future growth and adaptation of the teaching, research, scholarship, and other activities being supported.

It is desirable that investment policies are determined independently from expenditure policies. Spending is the by-product of total investment performance achieved. A financial objective is to maximize total return assuming a given level of risk. Many elements of investment policies are dynamic as well as complex. Important elements are selection of investment counsellors, markets, market constraints, asset mix decision, performance reviews, etc. From time to time, a major event can require expeditious and major decisions. Responsibility for overseeing investment policies and decisions rests with the Investment Committee of the Board of Governors and with designated administrative officers.

However, total independence between investment and expenditure policies could result in insufficient attention to current needs. Pressures for increased immediate spending always exist. A yield target should be established, subject to change from time to time, that balances expenditure needs with real revenue realities.

3. Endowment management should aspire to provide financial certainty and, thereby, program stability.

- (a) University endowment returns will enrich academic and related activities as the institution strives for excellence. Commitments made must be backed by a high level of financial certainty. Because the enrichment activities centre on people, program contraction is very difficult and saps morale as well as credibility. Our target should be to guarantee the level of funding commitment for a 3-year future time period. This would be viewed as a "rolling" assurance on an annual basis. The lower the commitment level, the greater the

assurance it can be sustained. Most institutions distribute returns between 4% and 5% of capital value; Alberta and Harvard set their yield decisions at 5%. The Government of Quebec requires endowment administrators to distribute at least 4.5% annually. A 5% target is an ambitious goal and one which would have to be monitored carefully over time.

- (b) A further measure is necessary to ensure financial certainty for managers of endowed academic programs. A stabilization reserve must be established to cushion the inevitable fluctuations of the investment marketplace. Often the reserve relates to handling of capital gains in the portfolio (realized *vs.* paper gains, portions of realized capital gains to provide for potential capital losses, etc.). It is necessary to recognize the role of reserves so that reasonable financial certainty can be provided for those responsible for administering activities funded by various endowments.
- (c) It is highly desirable that administrators of teaching, research, and scholarship programs be able to count on future growth over the next 3-10 year period. In an academic environment, resources to adapt to dynamic change are very important. Adaptation in conjunction with growth is usually more harmonious and effective. The future financial base is enlarged if current allocations include provision for growth. It is suggested that Dalhousie establish a 1% "future growth target".

4. Endowment management should be "revenue neutral" in terms of University administrative budgets.

Endowment funds are seen as providing enrichment to core activities so that merit can be supported and excellence pursued. It would be counter-productive indeed if the very activities required to fulfil the University's fiduciary and management responsibilities relating to endowments themselves would have a negative impact on core operations. The cost of administrative, accounting, auditing, and related tasks are a legitimate expense recoverable from the endowments themselves and should not be a drain on limited operating fund resources. Based on Dalhousie's own past experience in managing endowment funds, as well as findings at other universities, it is suggested that an "administrative recovery fee" equal to 0.5% of fund market value be implemented.

RECOMMENDATIONS

1. That the Board of Governors establish the primary goal of the unitized Endowments as purchasing power preservation (as measured by the Consumer Price Index) over time.
2. That the Board of Governors establish the annual real yield target as 5% of market value for the unitized Endowments for an initial three-year period, and annually hereafter should establish the yield target for the third year of a rolling three-year period.
3. That the Board of Governors establish the principle that endowment management should be "revenue neutral" in terms of the operating budget, and set the administrative recovery fee at 0.5% of market value of each fund.
4. That the Board of Governors establish as a component of the unitized Endowments stabilization reserves for the Killam and Other Funds to buffer investment market fluctuations. To the extent that actual income exceeds actual expenditures in any year, the balance would be retained in the appropriate stabilization fund.

5. That the Board of Governors establish a target for future growth of 1% of market value for the unitized Endowments. The target would be pursued through capital gains plus periodic transfers of funds from the stabilization reserves judged to be in excess of likely requirements.
6. That the Board of Governors agree that all new perpetual endowments established subsequent to the approval of this policy be managed in accordance with it, with due allowance for special conditions which might apply to Constrained or Special-Arrangement Endowment Funds.
7. That the Board of Governors agree that all perpetual endowments existing at the time this policy is approved (subject to any restrictive terms which may apply to such endowments) should be brought into line with the policy over time; the period of transition for each such fund should be as short as possible but as long as necessary to avoid or minimize program disruption.