

BROCK UNIVERSITY
Report to the Financial Planning and Human Resources Committee
Decision Item

TOPIC: 2011-12 Endowment Spending Rate

February 10, 2011
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The following was reviewed and approved by the Investment Committee at their meeting held on January 27, 2011.

The Financial Planning and Human Resources Committee is required to make a decision and recommendation to the Board of Trustees with respect to the endowment spending amount for the fiscal 2011-12 year.

BACKGROUND

- The “Trust & Endowment Management” policy governs decisions and timing regarding the endowment spending rate for the upcoming year.
- The spending rate for the last two years was set at 3%, 4.5% for the previous three years and previous to that, it was 5.0% for many years.
- Per the Trust & Endowment Management Policy, the spending rate will be reviewed annually based on a moving three-year average of the investment pool returns based on market values, measured as at June 30th, 2010, over the most recent 3 year period.
- Policy has been to calculate the next fiscal year’s spending rate based on the beginning book value of the Endowment Fund for the current year (i.e. the 2011-12 spending allocation is based on the beginning book value as at April 30, 2010)
- Typically, Brock’s decision has been made in the Fall in order for the Student Awards Office to announce scholarship and bursary amounts for the upcoming spring.
- Student Awards Office has advised that March is the latest that the spending decision can be determined as this is when their scholarship and bursary decisions and award offers are sent to new applicants.
- However, given the world economic crisis in 2008, the 2009 decision was deferred until January, 2009 to better assess the market situation. This timing followed the next year, and prior year’s decision was also made in January, 2010.
- It was determined at the fall meeting of the Investment Committee, that the 2011-12 endowment spending rate would again occur early in the new year in order to assess the markets and the endowment returns.

ANALYSIS

The Endowment Fund is currently managed by McLean Budden and Walter Scott. As of November 30, 2010, the following summarizes the market value of the investment holdings:

McLean Budden (Cdn Eq & Fixed Inc)	\$26,378,287
Walter Scott (established Aug, 2009)	17,849,158
Scotiabank (representing recent donations)	<u>892,692</u>
Total Market Value	\$45,120,137
Book Value	41,576,372
Unrealized appreciation	\$ 3,543,765

Based on the data we currently have, we were unable at this time to calculate the three-year moving average performance of the fund as at June 30, 2010. This was due to the change in manager structure in Fiscal 2009/10, a rolling 3-year average for the total fund as at June 30, 2010 could not be calculated as a result of this manager change. We do have information pertaining to the year-end figures.

The market value of the fund at April 30, 2010 was \$41.6M, with a book value of \$39.4M. A 3.0% payout based on the book value @ April 30, 2010 (as noted in policy) would approximate \$1,180,727 (\$1,102,758 for fiscal 2009-10, based on a book value of \$36.8M).

Annual performance over the last three fiscal years as at April 30th was approximately 17.1% (2010), -17.8% (2009), and -7.2% (2008), with a rolling three-year return of -3.7%. The annual change in the fund's unrealized gains/losses over the last three years as at April 30th has been \$5.7M (2010), -\$5.9M (2009), and -\$2.4M (2008). Clearly, the fund has not fully recovered from the financial crisis of 2008/2009.

PROPOSAL

The University Endowment Fund should be managed to provide ongoing support of endowed programs for perpetuity. The investment implication: a prudent approach to spending and reinvestment, using a spending formula, is necessary to provide protection against inflation over time.

Brock University has a fiduciary responsibility to our donors to protect the principal of our endowment and a contractual requirement with the Province of Ontario through its endowment matching program to not spend any of the principal of their matched funds.

A well designed spending policy takes for its conceptual framework the two principal goals of endowment management: providing a significant and stable flow of funds for student support over the short-term to provide resources to this generation of students, while at the same time maintaining the purchasing power of the endowment over the long term, thus ensuring Brock will be able to provide adequate resources to future generations of students.

Unfortunately, achieving both these goals requires Brock to make trade-offs. Satisfying today's students argues for consistent increases in spending unrelated to short-term Endowment performance to allow for steadfast student support on an inflation-adjusted basis. In severe bear markets, however, such a policy could result in under-performance, as consistent spending increases could potentially erode the purchasing power of the Endowment.

Satisfying future generations of students, on the other hand, argues for spending that fluctuates directly with Endowment market value changes. Under a spending practice following this consideration exclusively, declines in Endowment value would be immediately followed by declines in spending, preventing erosion in long-term purchasing power and protecting resources for future generations. Unfortunately, this spending practice could result in significant and disruptive volatility in the annual flow of funds to the operating budget and thus does not provide well for the current generation of students.

To balance the needs of all generations of students, Brock's spending policy should both be responsive to changes in Endowment value and minimize year-over-year fluctuations in spending. The ideal spending policy acts as a buffer, keeping short-term spending relatively stable but gradually allowing changes in Endowment values to filter into changes in spending. A properly functioning buffer allows Brock to pursue investment strategies that generate high returns over the long term without unduly worrying about the short-term impact on the student awards and allows the students of Brock to pursue educational and research work without unduly worrying about fluctuations in financial markets.

Brock's policy incorporates a spending rule that buffered spending volatility by averaging changes in Endowment value over a three-year period and by targeting a distribution rate that varied between 4.50% and 5.0% of that average. While that rule served well for many years, its ability to buffer the student awards from volatility in financial markets was overcome in the recent market decline of 2008/09.

As a result, Brock has suspended in part its spending rate policy, and established a rate of 3% for the last two years to provide an adequate buffer.

Furthermore, by maintaining the spending rate at 3%, we are providing an opportunity for the Endowment Fund to recover from the recent financial crisis while providing opportunity for inter-generational spending.

RECOMMENDATION

That the Financial Planning and Human Resources Committee recommend to the Board of Trustees that the endowment bursary payout rate for 2011-12 remain at 3%.