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
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** – Wasts 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 success.
What is portfolio risk?

risk = uncertainly 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.
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.
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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
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Chasing Intergenerational Equity
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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
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The impact of early market performance and upfront temp restricted assets on endowment performance

Key Concept

3 years operating cash
Key Concept

Chasing Intergenerational Equity

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

5 years operating cash
Funding Intergenerational Equity

Key Concept

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