



**FIDUCIENT**  
Advisors

# 6 TIPS TO MANAGING ENDOWMENT & FOUNDATION INVESTMENTS

A GUIDE FOR NONPROFITS

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**FIDUCIENT ADVISORS**

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## INTRODUCTION

The global pandemic caused unforeseen challenges for nonprofits that collectively serve millions of people. Can their endowments and foundations help mitigate these unprecedented difficulties?

This guide will help nonprofit executives as well as board and committee members effectively navigate this crisis through wise investment strategies.

### Nonprofit leaders must make timely investment and financial decisions

As a result of these challenging times, a wide variety of charitable organizations grapple with decreased revenues while demand for assistance soars. Healthcare organizations are impacted by the decline of profitable yet non-essential procedures, while demand for COVID-related services continues to rise, often taxing these organizations beyond their capabilities. Schools and other educational institutions are struggling with enrollment. Many associations are dealing with decreased revenue due to fewer, if any, conferences, which are a major source of funding. Cultural institutions lack the revenues collected from large crowds. The effects are substantial and far-reaching.

Such adversity requires smart and swift action, including difficult decisions. Nonprofit leaders must refocus on – and perhaps even reexamine – their mission.

This guide addresses six primary financial matters that, if poorly managed, could prove devastating, no matter how noble the organization's mission and cause. For nonprofit leaders to enable a sustainable positive financial outlook for their organizations, they must engage these integral six strategies:

- Establish new liquidity needs and **reprioritize financial goals**.
- Know when and how to **rebalance your portfolio**.
- **Update your Spending Policy** with essential changes.
- Evaluate and **reduce costs**.
- **Improve endowment investment results through strong governance**.
- **Continue fundraising** and communicate your investment strategy.

# Establish new liquidity needs and reprioritize financial goals

Many nonprofits have endowment or foundation portfolios designed to help their organizations successfully persevere through periodic challenges. But from a financial perspective, the magnitude and severity of this crisis is something not many, if any, organizations were fully prepared to manage. Countless nonprofits now must deal with three major impediments to their success, all happening simultaneously:

- Declining revenues
- Increased costs
- Market uncertainty and portfolio volatility

Nonprofit stewards must act swiftly to determine if liquidity requirements have or will change because of the pandemic. Of course, endowment and foundation investment committees will eventually strategize over asset allocation and portfolio rebalancing, but determining special liquidity needs that are essential to helping your nonprofit survive today is the top priority. We suggest a two-step process:

## 1) Create two new budget forecasts - The Hopeful and The Pessimistic

As a nonprofit leader, by now you probably contemplated how the crisis will affect your organization and what your charitable organization’s response might be in order to continue advancing your worthy mission. We will not delve into budgeting at great lengths here, but you and your team must conduct sufficient analysis in order to calculate any extraordinary liquidity reserves that are necessary to endure the crisis over the near term.

Your two updated forecasts should include a New Expected (Hopeful) Budget as well as a Worst Case Scenario Budget. In each, you will estimate how the next six to 12 months might unfold, taking into account projected declines in revenues, a higher cost structure, the value of your endowment portfolio and how much liquidity would be required under each scenario.

As new information on the pandemic surfaces daily, it is important to regularly update your two forecasts. Doing so monthly seems like an effective yet reasonable frequency. And if you are fortunate enough to oversee an endowment or foundation that appears to be healthy in size, be sure to do the math – vigilance is especially important in those cases because it is staggering just how quickly a nonprofit’s change in revenues or expenses can lead to a precarious condition.

CREATE TWO NEW BUDGETS (update monthly)	
New Expected (Hopeful)	Worst Case Scenario
<ul style="list-style-type: none"> <li>✓ Determine Extraordinary Liquidity Requirements for Each</li> <li>✓ Determine What Role Your Endowment/Foundation Should Play</li> <li>✓ Develop Tactics to Implement at Various Thresholds</li> <li>✓ Communicate Appropriately to Donors and Constituents</li> </ul>	

Nonprofit leaders might underestimate the substantial depletion of their organization’s resources as they contend with this or any other crisis. If leaders themselves lack this clarity, you can only imagine how misinformed donors and other constituents could be.

Consider Boston University’s (BU) seemingly large \$2.3 billion endowment. BU is situated in a major city and, like most schools, its endowment was working hard to help cover a portion of annual operating expenses before the pandemic. Schools lack certainty of how their deliverables or business model will evolve, but some constituents might assume that an institution with a large endowment or foundation can easily manage such challenges. Boston University’s President Robert Brown explains the realities of this situation: “People always use the size of an endowment as a metric of wealth. But as an endowment per student, we’re 160 on the list of private institutions.”

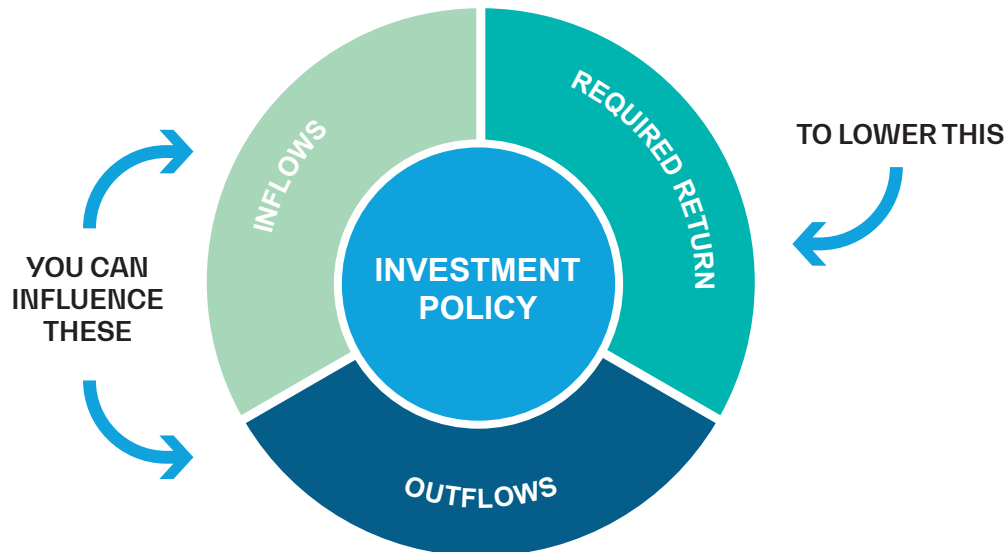
## 2) Conduct a *Three Levers* Exercise

Nearly all our clients participate in an exercise we refer to as the *Three Levers*. The levers include your nonprofit's Inflows, Outflows and Required Returns (endowment). Unfortunately, many organizations often overlook this essential step. Nonprofit boards and investment committees should engage in a *Three Levers* exercise before pursuing investment selection or even asset allocation strategy.

Using a systematic approach to establishing the organization's financial goals – and the corresponding required investment returns – is a best practice in ordinary times; however, during these times, it is not only a best practice but also in many cases key to survival as nonprofits attempt to recover financially from hardships caused by the pandemic.

### THE THREE LEVERS

Successful investors understand and appreciate the impact of each *Lever* and how it influences their organization.



Operating budgets, fundraising, capital projects and more must be incorporated. This constructive, somewhat clinical approach provides endowment and foundation stewards sound reason for establishing a particular investment return and risk level - and serves as a useful roadmap during turbulent times.

Unfortunately, no matter how prudent your investment committee members and their actions might be, they simply cannot control how stocks and bonds will perform.

What can nonprofit leaders influence? To some extent, they exercise influence over the inflows to the organization and even more so, the outflows. With an increase in market volatility, endowments may contend with lower investment returns for years. Now is the time to secure your budget and then make decisions, some unpopular, that provide your charitable organization with the best prospect of advancing its mission. Can you improve fundraising efforts? What costs should be eliminated? These and other critical questions must be answered.

Endowments and foundation investment committees characteristically include shrewd, caring individuals. Yet, despite these positive and practical traits, without an updated *Three Levers* exercise, these experts will lack the tools and foresight necessary to attain success in the near- and long-term future, no matter the circumstances. Only investment committees who possess a profound understanding of their nonprofit's financial picture and a realistic sense of the spending or drawdown expected from the endowment can responsibly establish and implement a prudent investment strategy.

# Know when and how to rebalance endowment portfolios

The five most dangerous words in investing might be: *It is different this time.*

But in many respects, the pandemic and its detrimental economic consequences compel nonprofit investment stewards to view current circumstances in a different way—a new and bold way. First, we must examine the most practiced rebalancing strategies used by investment committees. From there, we can then consider a thoughtful and timely approach to rebalancing portfolios during volatile times.

Asset allocation is the single most important determinant of investment performance, so endowment and other nonprofit stewards rightfully dedicate substantial time, resources and effort to determining their risk tolerance and optimal asset allocation mix. Then stocks and bonds do what they do – fluctuate, eventually shifting allocations from their intended targets. So, when and how should nonprofits rebalance a portfolio?

Too often, committees “fly by the seat of their pants” when it comes to the rebalancing decision. This is never a best practice but becomes a true shortcoming during a crisis or periods of substantial volatility. Committees generally rely on a handful of rebalancing techniques, each with its own benefits and drawbacks:

- 1. Arbitrary** – With this technique, rebalancing is based on gut feeling or emotion. Committee members may ask each other whether it is a good time to rebalance.
- 2. Tactical** – In this method, rebalancing is determined from short-term fundamental or technical considerations like GDP forecasts or stocks appearing to be technically oversold.
- 3. Time-dependent** – When employing this style, rebalancing is performed at a particular interval, such as every month, quarter or year.
- 4. Percentage bands** (a favored method for many investors) – Using this approach, a rebalance is required if an asset class deviates from a predetermined amount of the target. For example, investment-grade bonds may have a 20 percent target allocation, with rebalancing required at below 15 percent and above 25 percent.

### A Better Rebalancing Mousetrap?

Fiducient Advisors’s Portfolio Engineer<sup>®</sup> – This proprietary tool seeks to generate optimal rebalancing trigger points. The goals are to maximize return, hold risk constant and minimize implicit and explicit transaction expenses.

[Learn more here](#)

## How Good Stewards Should Rebalance Portfolios

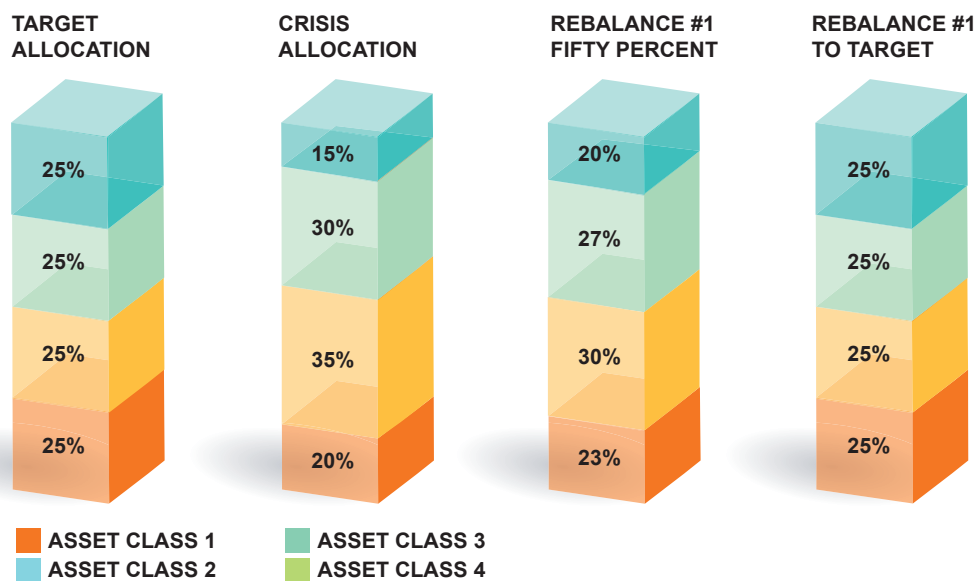
It is known that markets are forward looking, as investors project economic and company-specific performance. Anticipated outcomes are then reflected in the pricing of stocks and bonds. In effect, prospective investors continuously model potential results that in turn predict the relative attractiveness of an opportunity. Today we face an unusual, unprecedented challenge in that we will not have a true sense of the adverse economic consequences of the pandemic until we understand when businesses might begin to function near full capacity. This means that any “all-clear” signal will effectively be sounded not by economists but by doctors and scientists, who themselves are navigating extraordinary uncertainty.

Moreover, investors must acknowledge our personal biases. We all are hopeful this crisis is contained and that we won’t experience multiple waves. But at this point, investors lack clarity—as do medical professionals.

However, nonprofit investment committee members intending to act as good stewards are expected to be deliberate in their oversight of endowment portfolios. Recent volatility in stocks, bonds and alternative investments could have resulted in your endowment’s actual allocations being well off stated targets. Should investment committees simply sit on the sidelines and do nothing? Should they rebalance entirely back to target on a given day? We believe both alternatives are insufficient. Instead, we recommend this three-step strategy:

- 1. Determine unbudgeted cash needs before rebalancing.** As a result of this or any crisis, charitable organizations must contend with lower inflows (revenues, contributions, etc.) and higher costs (refunds, hazard pay, etc.). Leaders need to evaluate liquidity needs. Hospitals, universities, service organizations and other nonprofits may be forced to rely more on endowments for operational needs, and possibly draw down on portfolios much sooner than anticipated. A prudent steward’s first step should be to engage in an impromptu *Three Levers* exercise and set aside any extraordinary cash requirements.
- 2. Shift your endowment target now by half (if materially off target).** Each charitable organization’s circumstances are unique, and your investment or finance committee must assess the best course of action. But for endowments with allocations that are well off target, it is prudent to close the gap between your current allocation and your original target by half. Once again, do this after you have determined extraordinary cash reserves. This first swing back toward target increases allocations to asset classes that are more reasonably valued compared to perhaps just a short time ago – but also accounts for continued uncertainty and the possibility that asset classes appearing cheap today may in fact become cheaper still.
- 3. Shift toward your target allocation but do not necessarily expect to reach it immediately.** March 2020 was the most volatile month ever for the S&P 500 and, if history serves as a guide, volatility could be an unwelcome guest for quite some time. If your endowment sits modestly off target, rebalancing can be accomplished in any given day. However, if your portfolio experiences crisis-level dislocations, we suggest adopting a disciplined approach with partial allocations over several months, progressing gradually back toward endowment-target weightings.

### REBALANCING DURING CRISIS VOLATILITY



### Good nonprofit stewards should minimize their maximum regrets

Of course, it would be wonderful if we avoided additional waves of infections and stock market chaos, but if investment committees were certain this menacing crisis was largely behind us, they could simply rebalance endowments in typical fashion. But given that COVID-19 complicates the situation with unforeseen investment unpredictability, it truly is in a sense “different this time.” We believe adhering to this prudent three-step rebalancing process affords good stewards the best approach to managing their endowments and minimizing potential regrets.

# Update Your Spending Policy with Essential Changes

## Protecting Endowments with Responsible Spending Practices

In Chapter One of this guide, you were introduced to (or reminded of) the *Three Levers* that relate to investment management within the nonprofit world – inflows, outflows and required return. According to a recent CAF America survey, 93 percent of charitable organizations project a decrease in funding over the next 12 months<sup>1</sup>. If inflows will likely decrease and returns are largely out of our control, good stewards of endowment assets must turn their attention to outflows, or spending.

Naturally, analysis of a nonprofit's outflows hinges on analysis of the organization's spending policy. To preserve purchasing power and achieve intergenerational equity, which are generally considered to be the most important objectives of an endowment pool, a charitable organization must follow responsible spending practices.

### Types of Spending Calculations

There are many types of spending policies used by nonprofit institutions, the most common of which is the percentage of a moving average calculation. Below are various types of spending policies most frequently adopted by college and university endowments:

Spending Policy	Spending a percentage of a moving average of the endowment's market value	Grow last year's spending amount at a predetermined rate with upper and lower bands	Use weighted average or hybrid method	Spend all current income	Decide on an appropriate rate or dollar amount each year	Other spending policy
Utilization (% of respondents)	74.3%	3.9%	7.5%	2.1%	5.9%	11.0%

Source: 2019 NACUBO-TIAA Study of Endowments

The **percentage of a moving average** calculation is utilized by most nonprofit institutions and calls for a spending rate (typically somewhere between 4 percent and 5 percent) based on an average of the endowment value over time. The average is most frequently based on the endowment value over a 12-quarter period, though some endowments utilize longer or shorter periods. A general guideline is that using more data points to determine the average endowment value provides more stability in spending allowance. Using fewer data points will lead to a spending allowance that is very end-point sensitive and more closely tied to recent market conditions.

To illustrate, consider the difference between a nonprofit that uses an endowment spending rate based on a 12-quarter moving average, compared to another that uses a simple one-year average. Now assume that the spending calculation is performed at the conclusion of a difficult downturn, like the first quarter of 2020. In the first example, that tough quarter represents just 1/12th of the calculation – as opposed to the entire valuation when using a single year. Clearly, using fewer data points leads to a spending allowance that is more sensitive to market conditions, hence more volatile from year to year.

**One of the primary drawbacks to the percentage of a moving average policy is that periods of weak market conditions lead to reductions in spending allowance. Unfortunately, these very points in time tend to coincide with difficult stretches for nonprofit institutions.**

So while institutions struggle to fulfill fundraising goals and meet outside support needs, the spending policy calls for a reduction in spending dollars.

Some nonprofits, reluctant to establish a policy that necessitates spending cuts during difficult times, instead adopt an inflation-based policy that takes last year's spending and increases it by the inflation rate. Since this type of policy is so predictable, it simplifies the budgeting process. The inflation-based model also enables higher spending during difficult times as opposed to what a moving average policy can offer.

<sup>1</sup>CAF America COVID-19 Survey [https://www.cafamerica.org/wp-content/uploads/2020/04/CAF19\\_Report\\_VOL2.pdf](https://www.cafamerica.org/wp-content/uploads/2020/04/CAF19_Report_VOL2.pdf)



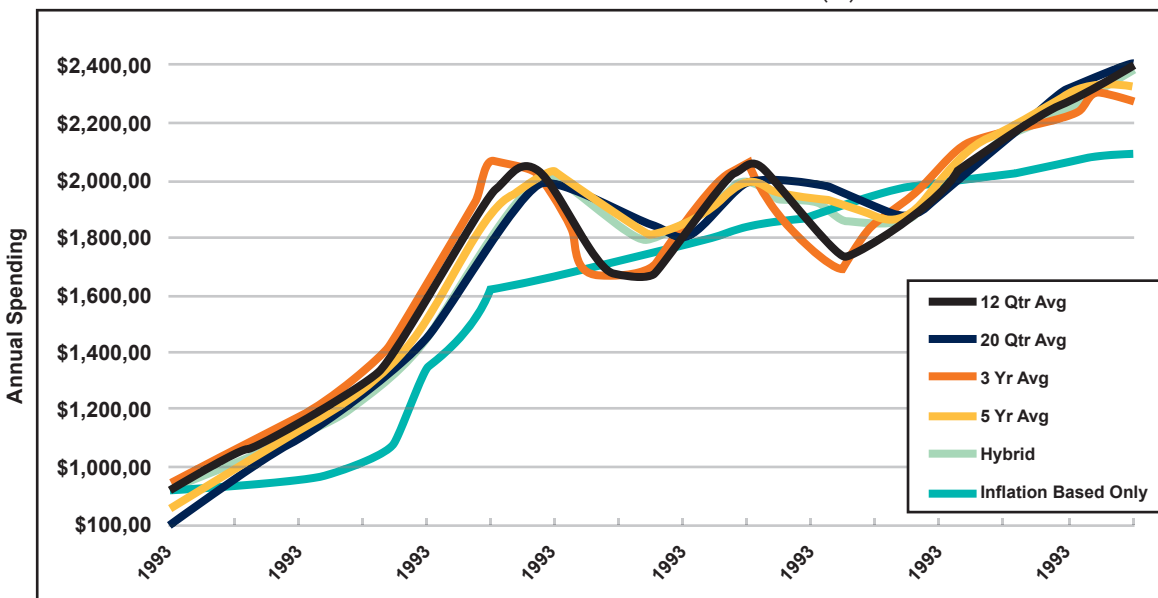
Typically, an inflation-based spending approach marginally links to market fluctuations by instituting a cap and a floor (e.g., the spending calculation cannot be less than 3 percent or more than 6 percent of the most recent year-end market value). However, the starting point of this calculation is extremely important as it could dramatically alter spending levels. For instance, if a nonprofit employs the inflation-based model after a period where spending has been high relative to history, the level of spending dictated by this policy may result in unsustainable spending levels, thereby reducing the corpus (and therefore taking away the organization’s ability to preserve purchasing power and create intergenerational equity).

Finally, the hybrid approach, as its name suggests, is considered by some to be the “best of both worlds.” Part of the calculation is based on a percentage of a moving average rule, and the remaining part of the calculation is based on last year’s spending plus inflation. Typically, bands are used with this type of policy just as they would be used with a pure inflation-based approach. The hybrid approach is utilized (and was made popular) by some larger universities, such as Yale and Stanford.

The hybrid approach creates a smoother and more predictable spending stream than the percentage of a moving average rule; in addition, this approach is not as likely to dissipate the endowment corpus like the inflation-based rule does.

The graph below depicts annual spending rates based on the various spending policy calculations.

**CHANGE IN ANNUAL SPENDING (\$)**



Sample portfolio using a starting market value of \$10 million in 1985, the first draw is taken in 1Q 1990. Assumes draws are taken annually. Assumes actual historical market returns, using a generic portfolio of 40% S&P 500 index, 30% MSCI EAFE Index, and 30% Barclays Aggregate Index. CPI non seasonally adjusted is the measure of inflation. This is not a direct representation of your portfolio or spending policy.

## Current Environment

The current market and economic environments have not only decreased endowment and foundation asset values, but have also created a challenging situation for nonprofit institutions. Colleges/universities and private secondary schools anticipate significantly decreased enrollment as they continue to deal with refund requests and financial insecurity among their student populations; artistic and cultural institutions are experiencing the economic impact of shelter-in-place measures and the potential reluctance of the broad population to revert back to previous activity levels once restrictions are lifted; and social service- and health-related organizations face increased demand for services while simultaneously seeing a decrease in funding and support due to the economic repercussions of the COVID-19 pandemic. It seems nary a single nonprofit sector has been impervious to the adverse impacts of the virus.

Many charitable institutions are relying more significantly on their endowment/reserve pools than they typically do to sustain themselves through the current environment. Some organizations may contemplate taking a special appropriation from the endowment to carry them through this or any crisis. If such a course of action is absolutely necessary to remain afloat, then of course sustaining the nonprofit is more important than preserving the endowment. However, we encourage stewards of endowment assets to pursue a special appropriation from the endowment **only under the direst of circumstances** because such an appropriation has a significant and long-standing impact on the endowment.

Our modeling<sup>2</sup> suggests that if a nonprofit organization with an endowment value of \$100 million were to make a \$10 million special appropriation from its unrestricted asset pool, 20 years down the road, with median results along the way, the negative impact to the endowment pool would be a disturbing \$15 million. In other words, an organization that did NOT take a special appropriation would have an endowment value \$15 million higher than the organization that did, assuming the same investment results. Furthermore, the cumulative spending dollars from the institution that did NOT take a special appropriation from the endowment would have been \$9.4 million higher than the cumulative spending dollars from the organization that did take the special appropriation. Therefore, **at the end of the 20-year period, the nonprofit that avoided a special appropriation would have \$9.4 million more in cumulative spending dollars and would also be left with an endowment value \$15 million higher** than the institution that did take the special appropriation. In other words, the impact of compounding is substantial and long-lasting.

### ENDOWMENT VALUE Median (50th Percentile) Market Returns

	No appropriation	\$10M Special Appropriation (year 1)	Difference
Starting Value	\$100M	\$100M	–
Year 10	\$122M	\$109M	\$13M
Year 20	\$147M	\$132M	\$15M

### CUMULATIVE ENDOWMENT SPENDING Median (50th Percentile) Market Returns

	No appropriation	\$10M Special Appropriation (year 1)	Difference
Year 5	\$21.1M	\$19.8M	\$1.3M
Year 10	\$44.4M	\$40.7M	\$3.7M
Year 20	\$99.0M	\$89.6M	\$9.4M

In fiscal year 2019, only 26 percent of endowments outperformed their spending rate plus CPI according to the 2019 NACUBO-TIAA Study of Endowments. Given the magnitude of the 2020 market downturn, we would be stunned if fiscal year 2020 yields a more favorable data point. When we revisit the primary objectives of endowment and foundation asset pools – preservation of purchasing power and intergenerational equity – the current environment and historical spending practices of nonprofit institutions may be antithetical to achieving those objectives. So, what are stewards of endowed assets to do?

<sup>2</sup>The Endowment Portfolio is representative of the median \$100 million-\$250 million portfolio as reported in the 2019 NACUBO-TIAA Study of Endowments. Assumes 6.1% annualized return and a 4% annual spending rate and \$10 million withdrawal in year one. Asset class returns represented by the following markets indices: BB Aggregate Bond, FTSE WGBI, Russell 1000, Russell 2000, MSCI EAFE, MSCI Emerging Markets, Cambridge Associate US Private Equity, HFRX Global Hedge Fund, FTSE NAREIT, BB Commodity.

Outputs and opinions are as of the date referenced and are subject to change based on market or economic conditions. Information is intended for general information purposes only and does not represent any specific investment recommendation. Please consult with your advisor, attorney and accountant, as appropriate, regarding specific advice. There is no guarantee that any of these expectations will become actual results. For additional information on forecast methodologies, please speak with your advisor.



EXPENSES

## Four Steps to Protect Your Endowment

### 1. Maintain a disciplined approach to spending:

- If you have a defined and functional spending policy, adhere to it.
- Approach spending policy from a long-term and disciplined perspective. Do not change your policy simply to take advantage of a larger spending allowance via a different calculation. Doing so will likely reduce your endowment corpus.

### 2. Be slow to take a special appropriation from your endowment:

- Do not take that special appropriation if you don't have to! It will have a long-lasting impact on your cumulative spending allowance and your endowment value.
- If you must draw down extraordinary amounts, be sure to examine and abide by any restrictions that may limit use of funds.

### 3. Anticipate cash needs and plan accordingly:

- If you know that you will need to spend from the endowment, inform your investment advisor in advance and provide as much detail as possible (e.g., amount of the draw(s), required timing, etc.) The advisor will work with you to develop a plan that considers market conditions, your target asset allocation profile and liquidity provisions of underlying assets.

### 4. If you have flexibility to lower your stated spending rate, do so!

- It may be increasingly difficult for most charitable organizations to lower their spending rates, especially in this current troublesome environment, and very few likely have the ability to reduce spending. But if you can reduce the endowment draw, it can have a positive impact on the endowment over the long term.

As one of the *Three Levers* that impact nonprofit endowment pools, Spending is a critical component of endowment management. As such, it is crucial that stewards of endowment assets closely monitor spending practices. In an increasingly volatile environment, maintaining a disciplined approach to spending; being thoughtful and proactive with cash management; and reducing spending whenever possible are more important now than ever before.

# Evaluate And Reduce Organizational Costs

For nonprofit board members, trustees and executives navigating uncertain economic times, reviewing costs in every aspect of the organization has never been more important. As endowment, foundation and reserve fund values decline and fundraising events are modified or cancelled altogether, it would be unwise to ignore the expense side of the income statement. Earlier, we focused on maintaining your organization's mission and reestablishing goals. But how can nonprofit leaders focus on these significant objectives while also carefully monitoring costs?

## Continue Spending on Development Efforts

Before considering anything else, we must address an area where nonprofits should not haphazardly seek to reduce expenses – development. This is a charitable organization's sales and marketing department. If fundraising wanes, the nonprofit loses revenue not only now but for years to come even after the economy rebounds. In times of stress and panic while nonprofits worry about demand and loss of potential donors, the typical response is often to indiscriminately slash budgets. Organizations may focus solely on monthly expenses without realizing the adverse effects of such measures to their strategic mission.

You must resist this temptation: **Avoid cuts that impair your nonprofit's capacity to raise money.**

Smart and nimble development officers must be creative in times of stress and duress. They can lay the groundwork for future donations by raising awareness of the mission without necessarily expecting immediate, tangible responses, financial or otherwise. They might even increase near-term revenue if they are able to effectively communicate current, unmet needs of the organization to large donors.

So with development and fundraising expenses largely excluded from budget reductions, what other options can a nonprofit examine to reduce costs?

## Eliminate Mission Creep Costs

As discussed in previous chapters, charities fortunate enough to have grown their reserve funds or unrestricted endowment assets should look to those assets to support the mission and keep the organization viable. However, now is the time for trustees and leadership to objectively assess which programs and activities may have fallen prey to "mission creep."

Most nonprofits are founded with a very specific mission, such as feeding the homeless, educating local inner-city children, providing healthcare to the community, etc. Over time, many successful nonprofits find themselves expanding their primary mission to other worthy and important causes. These initiatives often relate to the nonprofit's mission; therefore, they are usually justified and approved by the trustees and staff.

However, over time, various activities and programs might morph into something unwieldy that consumes valuable resources, time and money, more than ever originally intended. The more endeavors a nonprofit organization pursues, the more they become victims of such mission creep.

One of our advisors serves on a board of a wonderful nonprofit whose mission is to help inner-city middle school and high school students attend and graduate from four-year colleges. The organization has existed for about 10 years, and with much success – multiple cohorts completed the program, eventually graduating from college. But as we all know, life is just getting started after completing college. People need jobs, they might get married/divorced, have children, lose a job, become ill, etc. In short, life happens.

The nonprofit's staff had done such a great job of acting as surrogate parents to their students that they remained involved in their many struggles post-graduation. The trustees were torn about how to help the young adults with career and life guidance and counseling. These issues began cropping up on board agendas. While everyone agreed that these challenges were important and needed to be addressed for the alumni of the program, the reality was that their resolution was not central to the mission of the organization. The nonprofit simply did not have the resources or funding to expand scope and meet these additional needs.

Nearly every organization has ancillary programs or activities that began with the best of intentions, and these programs continued because they are worthwhile. However, especially during times of uncertainty, nonprofit stewards absolutely must ask themselves some tough questions, such as:

1. Is this program central to our mission?
2. Can we afford to keep it?
3. If we could only add one ancillary program, would this be the one?

If your nonprofit has yet to complete this exercise, the current economic climate presents an opportune moment to identify and eliminate programs representing mission creep.

## Review Vendor Costs to Identify Potential Savings

An easier task, and one that should occur on a routine basis, but especially during a crisis, is identifying above-market costs associated with vendors and outside service providers. As a nonprofit organization, you possess a valuable relationship with many of your partners. Whether outside vendors provide office supplies, cleaning services or banking services, you must express the financial stress your institution currently faces, benchmark comparable service fees and ask for a discount if said fees are not competitive.

During this process, nonprofit leaders should take the time to ask themselves and their staff the following:

- Is our vendor a true partner?
- Are they helping the organization by being proactive, delivering their services on time and exceeding expectations?

If the answer is yes, the vendor will most likely work with your organization to help you through this tough period, as they have proven that they view you as an appreciated, if not indispensable, long-term partner. **If the answer is no, then now is the time to find a new partner, one that will not only meet your needs but will also provide competitive pricing.** This is a challenging time for all organizations, for-profit and nonprofit alike, and your vendors should be working hard for your business.

Vendors that value your business **should be willing to work with you.**

While cost savings realized by reevaluating vendor relationships may not be as significant as cutting non-mission-oriented programs, it's a good place to start. Reaching out to vendors for concessions and compromises is not too difficult. In general, vendors that value your business should be willing to work with you.

Furthermore, these efforts do not create internal issues with employees and donors, which can be the case when reducing or eliminating programs. In times of crisis, every dollar is critical to the survival and long-term viability of your organization, and it is a nonprofit leader's responsibility to pursue cost savings whenever possible.

As it pertains to management of a nonprofit's endowment or foundation investment program, you should work with your investment consultant to benchmark custodial fees, investment manager fees, trading fees and other administrative costs. At Fiducient Advisors, we consistently and transparently disclose fee information for our nonprofit clients, which is a best practice in institutional endowment/foundation management.

## Reducing costs is more important now than ever

In conclusion, times of crisis give nonprofit leaders the opportunity to take a comprehensive and honest look at all costs associated with operating their organization.

Avoid indiscriminately reducing costs in development and fundraising. Do objectively evaluate your institution's activities and programs, discontinuing any programs where mission creep occurred. And finally, evaluate relationships with vendors in every area – cleaning, food service, banking, accounting, etc. – to be certain your nonprofit is paying reasonable and competitive fees and receiving valued service in return.

By objectively assessing costs and realizing savings opportunities, nonprofit organizations can plot a course through the current crisis toward a better, more sustainable future.

### TO CONTROL COSTS:



#### DO

- Evaluate mission creep
- Review vendor relationships
- Analyze costs



#### DON'T

- Cut development

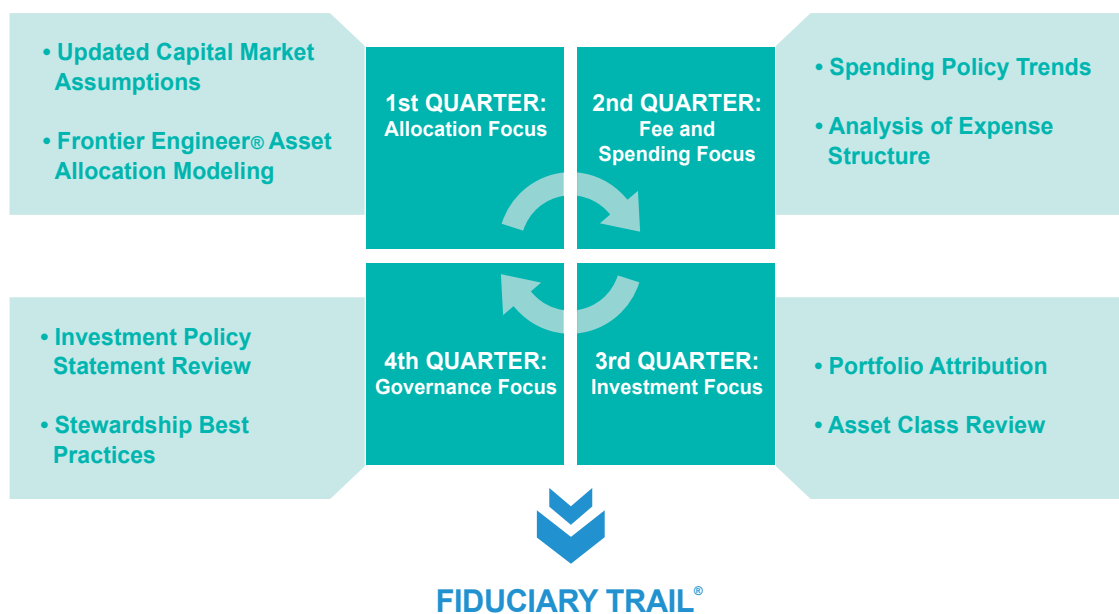


# Improve endowment investment results with strong governance

One of the most important factors in ensuring the long-term success of a charitable organization is committing to a strong governance process. Particularly as it relates to investment results, all too often stewards of nonprofit assets get mired in the short-term, asking ephemeral questions like: What was our performance for the quarter? How did our endowment/foundation perform relative to the benchmark? How did we perform when compared to our peers?

While these matters are not insignificant, they can cloud the big picture. Rather, nonprofit leaders tasked with overseeing perpetual investment programs (such as endowments and foundations) must remain focused on long-term strategy. By adhering to a disciplined governance process, nonprofit committees and boards are better able to meet their fiduciary obligations and ensure the long-term health of the organization.

A calendar-based approach to governance, like the one displayed below which we implement on behalf of our clients, provides the discipline and structure necessary to establish and maintain strong governance. This fiduciary governance calendar provides documentation that creates a Fiduciary Trail®. Over the course of a calendar year, this disciplined approach can help good stewards be certain that important fiduciary duties are addressed.



## Begin with overall financial goals for your charitable organization

Reviewing and re-underwriting a portfolio’s asset allocation profile on an annual basis is an important part of a structured governance process. This review includes analysis of risk and return expectations considering each organization’s stated return objectives (once again, we find ourselves referring to one of the *Three Levers* – specifically to the concept of required return). Since asset allocation is often considered the primary determinant of long-term investment results, it is critical that investment committees step back from discussions focused on short-term results and move forward by formally reviewing long-term expectations and portfolio positioning.

Focusing on fees and spending policy are other important aspects of governance. Again, there is a connection to the *Three Levers* – fees and spending make up the outflows. Being thoughtful and strategic with regards to spending and fees is crucial, particularly in challenging environments like the one we face with the COVID-19 pandemic, or any crisis.

Committees should periodically and objectively analyze which aspects of an investment program are working and which are not. Questions to ask include:

- *What additional asset classes should we be considering?*
- *Are there any asset classes that we should consider eliminating?*
- *How has our asset allocation positioning impacted historical performance?*
- *Has our manager selection been additive, or has it detracted?*

Investment committee members must think through these key questions and review them with their respective advisors regularly. Addressing these issues helps not only to evaluate historical results but also to position the portfolio appropriately for the future.

## Thoughtfully update investment policies

A strong and disciplined governance process requires sound governing documents. Concerning the investment program, the Investment Policy Statement (IPS) is the principal governing document. The IPS should serve as the blueprint for management of your endowment or foundation asset pool, and it is critical that investment committee members and all other relevant advisors be familiar with the IPS, strictly adhering to it. The IPS will generally include the following:

- Guidance regarding allowable asset class exposures
- Rebalancing procedures
- Return objectives

These aspects of the IPS help responsible parties maintain focus on the long-term strategy of the investment program. Good governance calendars often call for review and approval of the IPS annually.

And good governance of a charitable organization extends beyond investment strategy. Nonprofit leadership should be thoughtful about the number of members on the board and on underlying committees. A nonprofit board (or an underlying committee) that is too large may lead to disengagement, as board members may feel that their voice is unnecessary or gets lost in the crowd. In contrast, a small board (or committee) may lack perspective and varying viewpoints, and individual obligations may become too burdensome when a group is too small.

In addition, the nonprofit board must include individuals with diverse areas of expertise, backgrounds and points of view. Term limits are another important consideration with board governance. Term limits should be long enough to allow for institutional memory and consistency of approach but must not be so long as to prevent “new blood” from joining the board and offering fresh perspectives. Finally, board and committee leadership must be active and engaged, and this includes the nonprofit leaders being open to new ideas and encouraging of discussion.

In addition to the Investment Policy Statement, which provides the blueprint for management of a charitable organization’s investment program, other governing documentation should be equally robust. A formal written mission statement ensures that the board remains focused on what is essential to the organization. Board bylaws must be up-to-date, and all board members must comply. Meeting minutes should be circulated in a timely fashion and kept on file for historical reference. Making all relevant documentation available and accessible establishes a strong culture of governance.



## Three Steps to Building a Culture of Strong Nonprofit Governance

### 1. Create (and adhere to!) a checklist of responsibilities and obligations:

- We recommend the calendar-based approach for added structure and organizational accountability.

### 2. Be thoughtful about the construction of your committee or board and ensure that members have suitable characteristics. You should:

- Build diversity of background, expertise and opinion on the board/committee.
- Optimize size by ensuring the board/committee is neither:
  - Too large as to dissuade engagement
  - Too small as to lack diversity and overburden individual members
- Maintain term limits that allow for both institutional memory and fresh perspectives.

### 3. Have formal governing documents on file—and refer to them regularly. Such documents include:

- Investment Policy Statement
- Mission statement
- Board bylaws
- Strategic plan
- Meeting minutes

Committing to a strong governance process will not only provide discipline and structure, but will also encourage your nonprofit board and committee members to maintain a long-term approach toward the management of the organization and its realization of your much-valued mission statement. Having a formalized approach to governance will better organize, streamline and simplify the board's standard operating procedures, ensuring that stewards of nonprofit organizations remain disciplined in investing and fulfilling all their necessary responsibilities.



# Communicate Effective Strategies Focusing on Purpose and Progress

Again, we find ourselves focusing on one of the *Three Levers* – inflows. For this particular lever, fundraising plays a major role. As a charitable organization, how can you motivate your donor base, especially in the current environment? This is where communication and transparency become paramount to your fundraising success.

Just as you clearly define and disseminate your nonprofit's mission statement, you will need to demonstrate greater influence over your donors by developing an effective communication strategy that elaborates on the endowment, its purpose and its progress. This means investment committee members, board members and development staff alike must be informed, as they serve as public ambassadors for your nonprofit organization.

While each interested party need not know every intricate detail of the investment program, all stakeholders should be reasonably informed regarding the current size of the endowment, its target size and its broad asset allocation profile (e.g., a 70/30 equity/fixed income mix). Ensuring that stakeholders remain well-informed about the investment program requires foundational knowledge of the investment landscape, including the concepts of asset allocation, diversification, asset class designations, types of investment vehicles, etc. Your advisor can serve as a resource in providing basic education to your board members and other stakeholders.

**If the mission of a nonprofit organization is the engine, fundraising is the gasoline that fuels that engine.**

## Communicate clearly with donors and sustain development efforts

Many stakeholders may incorrectly assume that seemingly large endowments can - and should - be tapped to address budget gaps. But, based on a recent Forbes article, this is “neither financially responsible or prudent, nor is it permissible”<sup>3</sup>. Since endowment gifts contribute so meaningfully to the long-term sustainability of an organization, their critical importance cannot be overstated.

Being able to clearly communicate an investment strategy to current and prospective donors is a core characteristic of successful fundraising. If individuals are going to contribute to the endowment rather than provide a programmatic or project-based gift - which is often viewed as more exciting - they must feel confident that their gift will be invested in a strategic and responsible manner. This requires development staff to be well-informed in management of the endowment as they interact with donors in fundraising efforts. Development staff could be called on to provide an Investment Policy Statement or even a snapshot of the endowment portfolio and its performance. Clearly, in this case a basic understanding of how the asset pool is being managed is required.

Transparency about these inner workings of the endowment, including evidence of a sound investment strategy, will go a long way in making donors more comfortable with - and possibly more enthusiastic and energized about - the idea of contributing to the endowment.

**... endowments are not savings accounts earning CD-level interest. Nor are they rainy day funds... They are permanent funds, comprised of thousands of individual donor fund accounts, that generate spendable interest in perpetuity.**

- Forbes<sup>3</sup>

Development officers and nonprofit leaders should make the objective, mission and subsequent investment plan to achieve goals relevant to your donors. This requires creating an “investment story” that your current and prospective donors will find compelling as it will be consistent with your mission.

<sup>3</sup> <https://www.forbes.com/sites/davidrosowsky/2020/06/01/why-not-use-those-large-endowments-to-save-colleges/#4960727e3f0a>

## Three tips for successful endowment fundraising

### 1. Educate:

- o Development staff
- o Board members
- o Investment committee members

*Once informed, each stakeholder can serve as fundraising ambassadors for your nonprofit. But they cannot do so without first gaining a basic - and necessary - understanding of how the endowment portfolio is managed, which is why such education is so important.*

### 2. Communicate:

- o Be entirely transparent – especially with donors - about how the endowment is managed.
- o Offer to share important documents, such as the Investment Policy Statement or historical performance reports.
- o Extend invitations to meetings between prospective donors and the investment advisor(s).

### 3. Be a Convincing Storyteller:

- o Make your fundraising story relevant to donors.
- o Choose to highlight key details that resonate.

If the mission of a nonprofit organization is the engine, fundraising is the gasoline that fuels that engine. Fundraising to increase the endowment is a meaningful and productive endeavor central to the sustainability of your organization over the long term. In order to successfully raise endowed funds, you must be transparent about your investment strategy and communicate openly and honestly with current and prospective donors, making your organization's mission and its methods of achieving that mission relevant to them.

**Fundraising is motivating and asking others to share with you in a great adventure, a vision, a dream.**

– Jerold Panas (fundraising consultant)

## Conclusion

Some charitable organizations have never seen greater demand for their services. Others – due to the crisis – are operating at a fraction of historical levels. All face challenges they never envisioned.

As a leader of a nonprofit, you must navigate today's pressing issues while simultaneously attempting to advance the mission of your organization over the long run. The success, or failure, of your endowment's investment strategy may determine whether your nonprofit survives, or perhaps even thrives through this environment.

We applaud you and all good stewards for sharing their time, talent and treasure with charitable organizations that touch their hearts. For additional information or perspective on how your nonprofit might more effectively manage its endowment, please contact any of the professionals at Fiducient Advisors.

## Case Study

As illustrated in the following real-life example from one of our clients, a seamless and clear connection between your organization's main objectives and how you intend on managing the funds necessary to attain those goals is vital to all fundraising efforts.

Recently, we began working with a Catholic secondary school. Although their IPS made reference to investing according to Catholic guidelines, the endowment was not being managed in such a way. We identified the discrepancy and explained the situation and its ramifications to the Investment Committee, who raised the issue with the Board of Regents and the administration.

Ultimately, the school decided to adhere to the guidelines specified within the IPS; as such, we helped them create an investment portfolio that abides by the U.S. Conference of Catholic Bishops ("USCCB") guidelines. They now have the opportunity to proactively reach out to their donor base and inform them that the portfolio is being invested according to the same principles that guide the school's teachings, which will likely strike a chord with supporters and encourage more financial support.

The scenario outlined above may not apply to your nonprofit organization, but you can likely create a story from your own investment strategy that will motivate donors. Perhaps you have made an investment in an impact strategy that is helping to revitalize your organization's downtown area. Or perhaps you can simply convey a story about adhering to a disciplined and proactive rebalancing strategy during the Global Financial Crisis that enabled the endowment to participate in a market rebound rather than withdrawing from the markets out of anxiety. Creating an investment story that resonates with potential donors is one of the best ways to elicit endowment support.

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Bob's responsibilities include guiding and leading the firm's strategy as well as working with select clients. Bob has authored and been the subject of numerous articles appearing in prominent publications including the Los Angeles Times, Crain's Chicago Business and Pensions & Investments, and has taught courses on fiduciary responsibility and related subjects. He co-authored Asset Management for Endowments & Foundations (McGraw Hill), Designing a 401(k) Plan (Probus), The Practical Guide to Managing Nonprofit Assets (John Wiley & Sons), Nonprofit Asset Management (John Wiley & Sons) and recently authored 50 Billion Reasons to Grow Your Practice (Honor). Prior to co-founding Fiducient Advisors, Bob served as Vice President for Kidder, Peabody's Institutional Consulting Group, where he chaired their 401(k) consulting effort. Bob obtained the designation of Certified Financial Planner (CFP®) from the College of Financial Planning and his bachelor's degree from Bradley University. Bob has mentored at and currently serves on the board for Year Up Chicago. He is a board member for the Associated Colleges of Illinois, a board member for the Special Olympics Illinois Foundation and vice-chairs the investment committee for Catholic Charities of Chicago. Bob also serves as a director for the Geneva Lake Water Safety Patrol. Bob's interests include music, exercise, golf and boating...all the better with family and friends.

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**TIPS TO MANAGING ENDOWMENT  
& FOUNDATION INVESTMENTS**

A GUIDE FOR NONPROFITS