

A New Strategy For Educational Endowment Investment Management



H I G H L A N D

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CURRENT ENVIRONMENT

Higher Education and Private Secondary institutions face a challenging operating environment. Revenue growth will be hard to achieve due to a number of factors¹:

- Slow economic growth putting downward pressure on tuition increases;
- Sequestration and other Federal budget cuts decreasing available financial aid for students;
- Challenging State budgets (applicable to public institutions); and
- Rising competition from Massive Open Online Courses (“MOOC”).

In order to combat those pressures, many institutions face a corresponding pressure to raise expenses to attract potential students through facility and housing upgrades, new faculty positions, expanding course of study as well as developing their own solution / response to the MOOC trend.

HOW DOES THE CURRENT ENVIRONMENT CHANGE THE NEEDS OF EDUCATIONAL INSTITUTIONS?

The operating challenges facing educational institutions place an ever increasing importance on the strategic planning and efficiency of the internal staff. At the same time, new strategic initiatives, such MOOCs, and existing demands from the multiple pools of assets and constituents places a tremendous amount of stress on what can be lean Finance and Investment staffs.

Specific to Higher Education, there is a bifurcation in the staffing levels of endowments as those with assets of \$1billion or more have larger staffs dedicated to investments (10+ positions) while smaller endowments \$1billion or less are very lean (1-3 positions)².

	Total Institutions		Over \$1 billion		\$500 million - \$1 billion		\$100 million - \$500 million	
Respondents	823	831	73	68	66	71	251	250
Year	2011	2012	2011	2012	2011	2012	2011	2012
Average FTE's	1.6	1.6	10.2	10.9	2.3	2.7	1.1	1.1
Median FTE's	0.5	0.5	6.0	7.0	2.0	2.1	0.8	0.8

Note: This chart details public institution staffing but there was no significant difference in staffing level of public and private institutions

TOPICS:

- Current operating environment for Higher Education & Private Secondary Institutions
- How the current environment changes the needs of educational institutions
- The “Operating Endowment” point of view
- An example of the “Operating Endowment” put into practice
- How Highland’s experience aligns with the changing environment and current needs of educational institutions

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In looking further behind the “Over \$1billion” category, the largest endowments with \$10billion or more have very large staffs (often 20+ positions) while the endowments closer to the \$1billion level have staffs more in the 3-5 positing range.

For all educational institutions, in addition to the level of staff, the internal teams often possess more of an investment background and may have limited experience in operational and / or treasury functions.

- The operational functions for complex, not-for-profit organizations includes a number of non-investment related tasks such as:
 - Plan accounting – managing multiple pools of assets in a single, master relationship; and
 - Cash movement and allocation – providing liquidity to the constituents as needed while monitoring endowment level and individual constituent policies.
- The responsibilities of a treasury function also includes a number of non-investment related tasks such as:
 - Debt – issuance and management;
 - Accounting – pooled accounting for the investment program; and
 - Relationship Management – banking, audit, regulatory, rating agency, etc.

With the rising operating challenges, often limited staffing, and internal experience more focused on investments, educational institutions now need their external service providers to offer a different type of advice than has been required in the past:

- Customization – experience in tailoring an investment program specific to multiple pools of assets and constituents;
- Flexibility – willingness to provide an investment program that is not model based but responds to changes in the needs of underlying pools of assets and constituents;
- Operational Support – practical experience in operational and treasury functions to provide operational support, back-up for internal staff, and organizational risk control through process and procedure; and
- Partnership – willingness to spend the time necessary with each and every constituent to determine their unique objectives and constraints and to design an investment program that meets those needs and leverages every asset of the organization to fulfill the mission.

Today’s educational institutions need an advisor that has experience in coordinating all the components of the organization into a single, cohesive “Operating Endowment”.

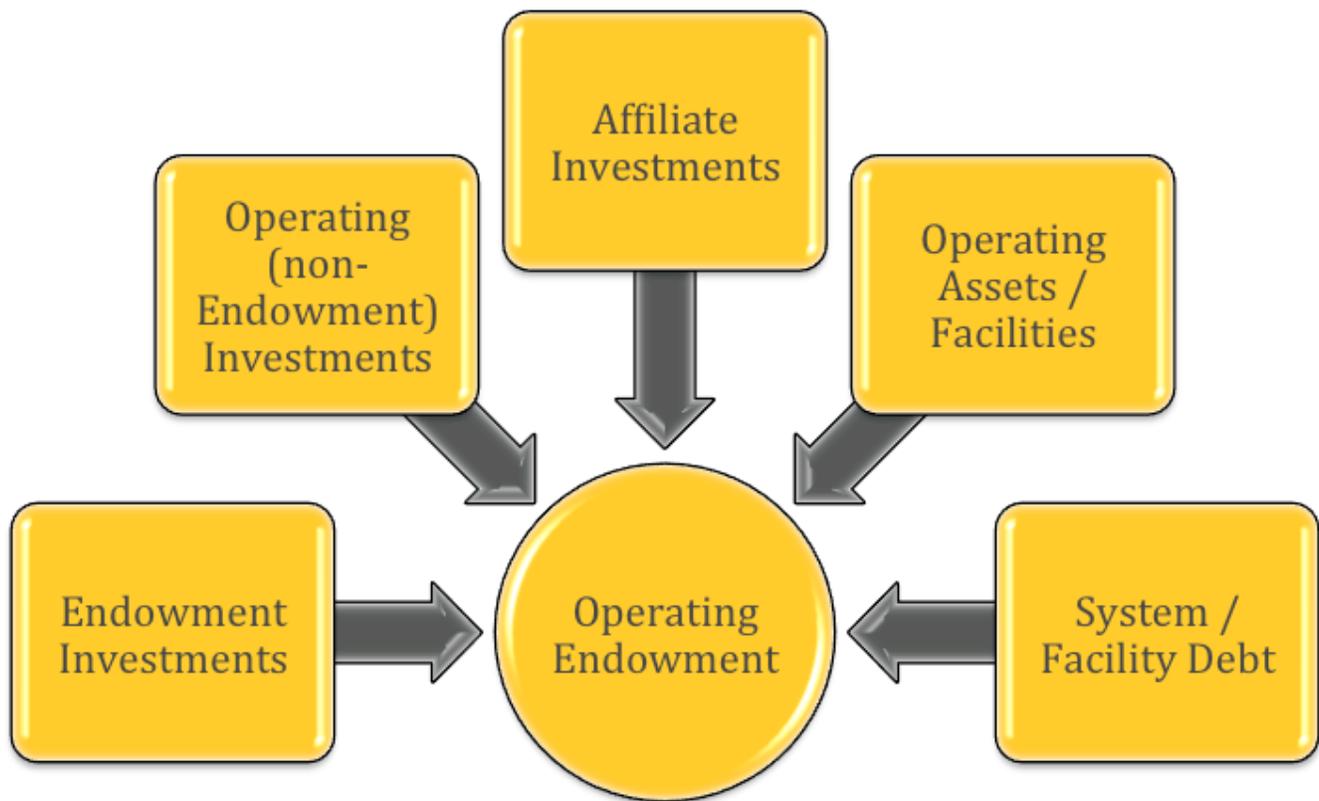
WHAT IS THE “OPERATING ENDOWMENT” POINT OF VIEW?

The **Operating Endowment** point of view recognizes that the many components of educational institutions are inextricably linked and that investment strategy and operations should reflect that realization.

- Endowment funds – perpetual assets with a spending policy;
- Operating funds – assets used to fund operations and offset debt issuance;
- Affiliate organizations and foundations; and
- Operating assets – campus facilities, land, etc.

Additionally, many Higher Education institutions have multiple constituents within each pool of assets – different campuses with unique characteristics, affiliated health systems and / or medical schools, etc. – which must be addressed based on their individual objectives and constraints.

This total capital evaluation integrates the varied pools of assets as well as any debt issued by the institution into a complete investment program designed to fulfill the mission of the organization.



THE “OPERATING ENDOWMENT” MODEL PUT INTO PRACTICEHIGHER EDUCATION ENDOWMENTThe Problem:

- Balancing the long-term horizon of a perpetual endowment with numerous factors that must be considered in the overall objectives (risk, return) and constraints (liquidity, time horizon, special circumstances) evaluation.
- Multiple campuses with:
 - Unique operating environments - enrollment growth, academic programming, facility needs, etc.;
 - Differing levels of debt; and
 - Differing operating cash balances and cash needs.

The Solution:

- Pooled investment program with the flexibility to tailor allocations to the individual constituents.
- Investment allocations that balance:
 - The return objective that funds the mission of the System;
 - Facility / System level debt as a part of the overall risk tolerance evaluation; and
 - Future capital requirements and projected funding source (debt, philanthropy, etc.).

The Outcome:

An investment program that supports the mission of the System while properly balancing the individual objectives and constraints of the underlying constituents.

PRIVATE SECONDARY ENDOWMENTThe Problem:

- Balancing the long-term horizon of a perpetual endowment with numerous factors that must be considered in the overall objectives (risk, return) and constraints (liquidity, time horizon, special circumstances) evaluation.
- Single campus with unique operational characteristics:
 - Enrollment growth;
 - Facility needs; and
 - Existing debt.

The Solution:

- Investment allocations that balance:
 - The return objective that funds the mission of the School;
 - School debt as a part of the overall risk tolerance evaluation; and
 - Future capital requirements and projected funding source (debt, philanthropy, etc.).

The Outcome:

An investment program that supports the mission of the School while properly balancing the operating characteristics of the School including debt, enrollment, and sources of revenue.

ABOUT HIGHLAND:

Highland Associates, Inc. was founded in 1987 as an independent institutional investment advisor to assist not-for-profit institutions in the development, implementation, and maintenance of treasury and investment management programs.

The firm is headquartered in Birmingham, AL and, as of December 31, 2013, serves as investment consultant on approximately \$18 billion in assets.

The information provided herein is not intended to be, nor shall it be construed as, investment advice or a recommendation of any kind. To the extent that this communication contains information as to the historical performance of a particular investment or strategy, no representation is being made that an investor will or is likely to achieve any results shown or will make any profit at all or will not suffer losses, including loss of principal. Past performance is not indicative of future results. The information provided is furnished as of the date shown, and no representation is being made with respect to its accuracy on any future date.

HIGHLAND'S EXPERIENCE ALIGNS WITH THE CHANGING NEEDS OF EDUCATIONAL ENDOWMENTS

Highland was founded on the basis of the Operating Endowment philosophy – that every asset, liability, and operational aspect of an organization must be considered when designing an investment program. By doing so, we believe we provide our clients with the best opportunity to set proper expectations and fulfill their mission.

Highland possesses more than 25 years of practical experience in partnering with large, complex not-for-profit institutions to design, implement, and maintain a customized investment program.

We do not believe in model portfolios. All of our clients are unique, even if they operate in the same industry, and their allocation reflects their individual objectives and constraints.

Highland's service model includes multiple points of contact for each relationship along with full access to our administration area which serves as a valuable resource to our client's internal staff and provides operational support and operational risk management / back-up.

Finally, Highland believes that a strong partnership can only be built through personal contact and time. We spend a great deal of time with our clients and every constituent they serve to ensure that the investment program meets the needs of each constituent and the institution as a whole.

Please contact any of us to schedule a time to discuss your specific endowment needs.

ENDNOTES:

¹ 2014 Outlook – US Higher Education, Not-for-Profits and Independent Schools. Moody's Investor Service. November 25, 2013

² NACUBO-Commonfund Study of Endowments®, 2012

**Bill A. Terry, CFA****Co-founder | Principal | bterry@highlandassoc.com | 205.933.8664**

Mr. Terry is an original founder of Highland Associates. He is a principal of the firm and a shareholder. Prior to forming Highland Associates, Mr. Terry co-founded and co-managed the Investment Management Consulting Group of Interstate/Johnson Lane securities. Mr. Terry is a member of the Board of Directors for Protective Life Corporation, a NYSE listed company, where he serves on both the Finance and Investment, and Audit Committees. In addition he serves as immediate past Chairman of the Executive Board of the Greater Alabama Council of Boy Scouts of America and on the Finance Committee of the Birmingham Museum of Art. Mr. Terry holds a Bachelor's of Arts degree from Davidson College and is a CFA Charterholder. Mr. Terry has 31 years of investment experience.

**Charlie D. Perry****Co-founder | Principal | President | cperry@highlandassoc.com | 205.933.8664**

Mr. Perry is an original founder of Highland Associates. He is a principal of the firm and a shareholder. Prior to forming Highland Associates, Mr. Perry co-founded and co-managed the Investment Management Consulting Group at Interstate/Johnson Lane Securities (a New York Stock Exchange Listed Company). Mr. Perry currently serves as the chair of the Investment Committee for the University of Alabama at Birmingham Health Services Foundation and sits on the Board of the Health Services Foundation, the University of Alabama Health System, the UAB Medical Leadership Committee and the Comprehensive Cancer Center of the University of Alabama at Birmingham. He is the current Vice Chairman and past President of the Alabama Symphony Orchestra and is Chair of the Alabama Symphony Endowment. He earned his Bachelors of Arts in Economics from Washington and Lee University. Mr. Perry has 37 years of investment experience.

**Michael T. Lytle, CFA****Consultant | mlytle@highlandassoc.com | 205.933.8664**

Mr. Lytle joined Highland Associates in 2006 as a consultant to the firm's institutional client base. He is a shareholder in the firm. Prior to joining Highland Associates, he worked as a fixed income portfolio manager in AmSouth Bank's Asset Management Department. Mr. Lytle is the Chairman of the Investment Committee of the Greater Alabama Council of Boy Scouts of America, serves on the advisory board for the Department of Economics, Finance and Quantitative Analysis at Samford University and is a past president of the Vestavia Hills Library Foundation. He is also the Chairman of the Finance Committee and Vice-Chair of the Deacon Board at Dawson Memorial Baptist Church. Mr. Lytle earned his Bachelors of Science from Berry College. He is a CFA Charterholder and past board member and president of the CFA Society of Alabama. Mr. Lytle has 15 years of investment experience.

**Paige B. Daniel****Consultant | pdaniel@highlandassoc.com | 205.933.8664**

Ms. Daniel joined Highland Associates in 2006 as a consultant to the firm's institutional group. She is a shareholder in the firm. Prior to joining Highland Associates, she was director of alternative strategies with AmSouth Bank's Wealth Management Group. Ms. Daniel also worked for CIBC Oppenheimer and with Quick and Reilly. She is a member of the YWCA of Central Alabama's Board of Directors and Endowment Committee. She is also on the Executive Committee and Board of the Parkinson's Association of Alabama. Ms. Daniel serves on the Board of the Girl Scouts of North Central Alabama and chairs their Finance Committee. She earned her Bachelors of Arts in Economics from Vanderbilt University and her Masters of Business Administration from Georgia State University. Ms. Daniel has 19 years of investment experience.

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Mr. Graham joined Highland Associates in 2006 as a consultant to the firm's institutional client base. He is a shareholder in the firm. Prior to joining Highland Associates, he worked at Vulcan Materials Company as a senior financial analyst. Mr. Graham previously worked at CNHI and NCP Solutions in an analyst role. Mr. Graham earned his Bachelors of Science in Finance from Troy University and his Masters of Business Administration from the University of Alabama at Birmingham. He is a CFA Charterholder and a member of the CFA Society of Alabama. Mr. Graham has 11 years of investment experience.