

Overview of The University of Chicago Endowment



THE UNIVERSITY OF
CHICAGO

April 13, 2017

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Endowment Funds – Four Questions

- **First**, a financial question from my lovely wife Mary Lou, a first grade teacher – How much did the pirate pay to get his ears pierced?
- **Second**, what is an endowment?
- **Third**, what is the University payout rate?
- **Fourth**, how much payout can you expect from a \$1 million gift?

What is Endowment?

- **Oxford:** “To enrich with property; to provide by bequest or gift; a permanent income”
- **Webster:** “The part of an institution’s income derived from donations”
- **AICPA:** “Funds... which a donor or other outside agencies have stipulated, as a condition of the gift instrument, that the principal is to be maintained **inviolable and in perpetuity** and invested for the purpose of producing *present and future income...*”
- **Another term for the above is.....”True Endowment”**

- **What are some other types of endowment?**

Other Types of Endowment?

- **Funds Functioning as Endowment:**

- “Funds which the governing board of an institution, rather than the donor..., has determined are to be retained and invested. Since these funds are internally designated rather than externally restricted, the governing board has the right to decide at any time to expend the principal.”
- Sometimes Called “QUASI”
- Usually Established for a Minimum Period of Time. *Why do you think this might be a good idea?*

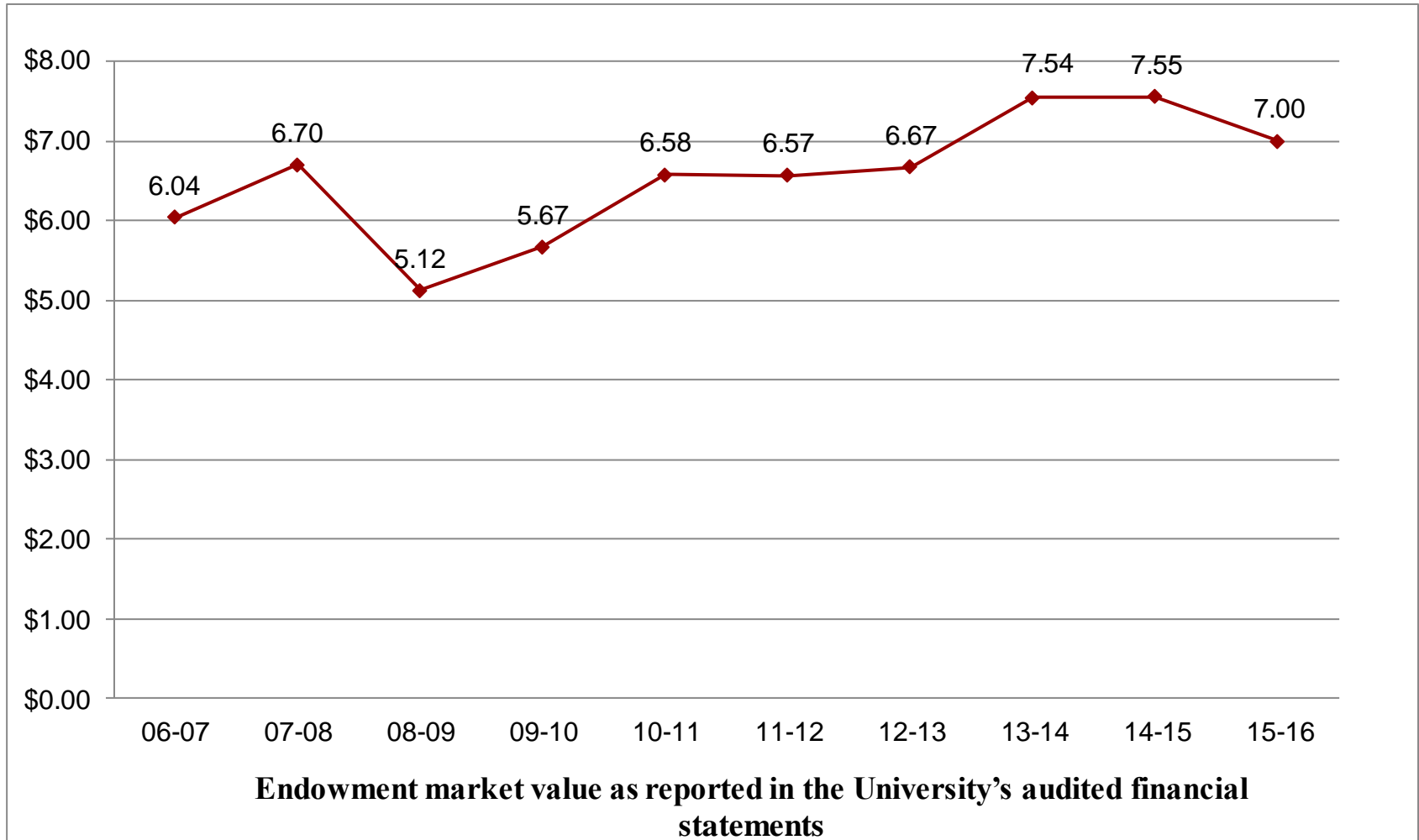
- **Term Endowment:**

- “Funds similar to (true) endowment funds except that, upon the passage of a stated period of time or the happening of a particular event, all or part of the principal may be expended.”
- Popular in the 1960’s....spotty since then.

The University of Chicago – Endowment Funds

- From the American Council on Education “Understanding Colleges & University Endowments...”
 - “One of the most important responsibilities of trustees is to oversee the management and allocation of the institution’s assets. Trustees are legally obligated to be prudent in their investment management, but they also should make every effort to achieve as substantial a return as prudence will allow.”
- Trustee Investment Committee has oversight and responsibility for the University Endowment.
- 97% of the University Endowment merged into a single fund called the “Total Return Investment Pool” (TRIP).
- The University has approximately 3,700 separate endowment funds.

Historical Endowment Market Value (in billions)



Market Value of Endowment by General Purpose

- For GAAP reporting purposes, endowment is classified into three buckets:
 - Unrestricted = funds functioning as endowment
 - Temporarily Restricted = appreciation on true endowment and term endowment
 - Permanently Restricted = original gift value of true endowment
- As of June 30, 2016, the University's endowment served the following purposes:

	As of June 30, 2016			
<i>(in thousands)</i>	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Unrestricted	440,053	253,220	76,432	769,705
Instruction & Research	700,672	869,140	588,227	2,158,039
Library	57,634	52,341	31,312	141,287
Student Aid	105,328	429,672	539,740	1,074,740
Lectureships	2,940	18,679	13,359	34,978
Professorships	76,027	732,371	443,854	1,252,252
Medical Center	804,437	67,401	8,102	879,940
Other	395,236	190,649	104,380	690,265
Total	2,582,327	2,613,473	1,805,406	7,001,206



Endowment Funds – Portfolio Breakdown

Portfolio breakdown @ June 30, 2016

○ Global Equities	22.3%
○ Private Equity	15.1%
○ Private Debt	5.0%
○ Absolute Return	31.3%
○ Real Estate	6.4%
○ Natural Resources	6.2%
○ Fixed Income	10.6%
○ TRIP Protection	2.0%
○ Cash and Equivalents	<u>1.1%</u>
Total	100.0%

Does the University have a separate pool for socially conscious investments?

Endowment Funds Average Rates of Return

- Average rates of return for year ending:

	<u>06/30/16</u>	<u>06/30/15</u>	<u>06/30/14</u>
One year	-1.9%	4.8%	12.7%
Three years	5.1%	8.0%	8.7%
Five years	5.7%	9.8%	12.6%
Ten years	6.3%	8.4%	9.6%
Twenty years	9.6%	10.6%	11.2%

The University of Chicago Endowment Payout

- Annual payout to each endowment fund is based on shares of ownership times the payout per share.
- Payout rate based on a formula approved by the Trustees.
- Endowment payout formula
 - Limits spending between 4.5% and 5.5% of TRIP market value.
 - Averages market value over twelve quarters.
 - Long-term objective is a 5% payout rate over time.

TRIP Payout Formula: The Policy

- “The University utilizes the total return concept in allocating endowment income. In accordance with the University’s total return objective, between 4.5% and 5.5% of a twelve-quarter moving average of the fair value of endowment investments, lagged by one year, is available each year for expenditure in the form of endowment payout. The exact payout percentage is set each year by the Board of Trustees with the objective of a 5% average payout over time.
- Formula Payout Rates for the past six years have been:

Fiscal 2011	5.50%
Fiscal 2012	5.50%
Fiscal 2013	5.50%
Fiscal 2014	5.50%
Fiscal 2015	5.50%
Fiscal 2016	5.50%
- Note, the Fiscal 2017 payout rate is 5.50% and the Board is expected to approve a 5.5% payout rate for Fiscal 2018



TRIP Payout Formula: The Rationale

- From the American Council on Education, *Understanding College & University Endowments*
 - “There is always a temptation to increase current spending to meet the very real needs of today’s students and faculty. But this generation could not be supported at today’s level of spending if earlier generations had not had the discipline to sustain the purchasing power of their endowments.”
- To sustain purchasing power of the endowment, the University divides each year’s earnings between dollars that are spent immediately and dollars that are added to principal in order to protect the future purchasing power of the endowment. **Against the ravages of inflation!**

TRIP Payout Formula: The Rationale (continued)

- That was then:
 - 5% payout rate based on an assumed sustainable long-term rate of return on endowment assets of 8.0% and estimated inflation of 3%.
- This is now:
 - 5.5% payout rate based on an assumed sustainable long-term rate of return on endowment assets of 7.5% and estimated inflation of 2%
- Payout rate set to approximate expected long-term “real return” on endowment assets.
- Twelve quarter average of market values meant to smooth the calculation to avoid large “bumps” in the payout from year to end.
- Range between 4.5% and 5.5% provides flexibility to control the growth of the payout in periods of significant market growth and increase the payout in times of depressed markets.



TRIP Payout Formula: It's All About the Shares

June 30, 2016:

- Market Value =
\$7,112,667,110
- Number of Shares =
301,179,987
- Market Value/Share =
\$23.616002

June 30, 2015:

- Market Value =
\$7,575,584,032
- Number of Shares =
296,201,203
- Market Value/Shares =
\$25.575804



TRIP Payout Formula: Fiscal 2015 – 16 Calculation Details

TRIP Market Value per Share	
09/30/11	23.616043
12/31/11	23.258283
03/31/12	23.856039
06/30/12	24.055719
09/30/12	24.147960
12/31/12	24.222319
03/31/13	24.399880
06/30/13	24.256198
09/30/13	24.587606
12/31/13	24.641753
03/31/14	25.331220
06/30/14	25.817276
TOTAL	292.190296
12 Quarter Average	24.349191
5.50% Payout/Share	1.339206

TRIP Payout Formula: Fiscal 2016 – 17 Calculation Details

TRIP Market Value per Share	
09/30/12	24.147960
12/31/12	24.222319
03/31/13	24.399880
06/30/13	24.256198
09/30/13	24.587606
12/31/13	24.641753
03/31/14	25.331220
06/30/14	25.817276
09/30/14	25.671333
12/31/14	25.508180
03/31/15	25.784212
06/30/15	25.575804
TOTAL	299.943741
12 Quarter Average	24.995312
5.50% Payout/Share	1.374742



TRIP Payout Formula: Question

- The fiscal 2010 return on endowment was 18.9% and the effective payout rate as a percentage of market value was around 6.1%. What happened to the rest of the return?

TRIP Payout Formula: Investment Return Reinvested

Investment return:

Yield	\$	58,452
Investment gain		936,964
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	\$	995,416
Endowment payout		(341,859)
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Net investment return reinvested	\$	653,557
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- What do you think the University did with the \$654 million and why?
- Let's take a look at investment return results when the picture isn't as good...such as Fiscal 2009.



TRIP Payout Formula: Question

- The fiscal 2009 return on endowment was -21.5% and the effective payout rate as a percentage of market value was around 4.6%. How could we afford a payout if the endowment is losing money?

TRIP Payout Formula: Net Investment Deficit – FY 2009

Investment return:

Yield	\$ 39,131
Investment loss	<u>(1,367,956)</u>
	(1,327,956)
Endowment payout	<u>(314,752)</u>
Net investment loss	\$ <u>(1,642,708)</u>

- How could the University distribute a payout given negative TRIP returns?

TRIP Payout Formula: Question

- The University of Chicago has a \$7.0 billion endowment and a \$470 million payout. Do they have it made!

TRIP Payout Formula: The University “has it made” ????

- Total endowment = \$7.0 billion
- Endowment payout = \$.47 billion
- Expenditure base = \$3.8 billion

- Payout as a % of expenditures = 12%
- Expenditures to be covered from other sources = 88%
- Does the endowment cover it all??

TRIP Payout Formula: Practical Application

- A donor asks how much payout to expect from her recent \$1,000,000 endowed fellowship gift. How do you respond?
- \$55,000 (5.5% of the gift value)?

Gift	\$1,000,000
÷ TRIP MVPS	<u>\$23.616002</u>
= TRIP shares purchased	42,344
X FY 2016-17 Gross P.P.S	<u>\$1.374742</u>
	\$58,212
X 10% management charge	<u>(\$5,821)</u>
= Available for fiscal 2017 fellowships	<u><u>\$52,391</u></u>



Fiscal 2016-17 TRIP Endowment Payout “Spot Rate”

- “Spot Rate” = payout/beginning of year market value
- Note the difference between the gross and net payout

	Market Value/ Share	Gross Payout	Net Payout	Gross Payout/ Share	Net Payout/ Share
09/30/12	\$24.15	\$1.37474	\$1.23727	5.69%	5.12%
12 Q Avg.	\$25.00	\$1.37474	\$1.23727	5.50%	4.95%
06/30/15	\$25.58	\$1.37474	\$1.23727	5.37%	4.84%
06/30/16	\$23.62	\$1.37474	\$1.23727	5.82%	5.24%

Questions



(5) **Endowments**

The University's endowment consists of approximately 4,000 individual funds established for a variety of purposes. The endowment includes both donor-restricted "true" endowment funds and funds designated by the Board to function as endowments commonly referred to as "funds functioning as endowment". Net assets associated with endowment funds, including funds functioning as endowment, are classified and reported based on the existence or absence of donor-imposed restrictions.

The University, Medical Center, and MBL endowment each invest in an investment pool, the Total Return on Investment Pool (TRIP). As of June 30, 2016, 99%, 76%, and 100% of the University, Medical Center, and MBL endowments respectively, are invested in TRIP.

(a) *University Endowment*

Changes in the fair value of the University endowment investments and net assets by type of fund were as follows for the fiscal year ended June 30, 2016:

	2016			
	Unrestricted	Temporarily restricted	Permanently restricted	Total
Changes in the fair value of endowment investments				
Investment return:				
Endowment yield (interest and dividends)	\$ 18,676	42,435	427	61,538
Net depreciation (realized and unrealized) on investments	(50,240)	(161,783)	(1,779)	(213,802)
Total investment return	(31,564)	(119,348)	(1,352)	(152,264)
Endowment payout	(180,291)	(233,090)	(1,990)	(415,371)
Net investment return	(211,855)	(352,438)	(3,342)	(567,635)
Other changes in endowment investments:				
Gifts and pledge payments received in cash	—	223	114,272	114,495
Transfers to create funds functioning as endowment	24,445	—	—	24,445
Other changes	(24,645)	27,320	9,214	11,889
Total other changes in endowment investments	(200)	27,543	123,486	150,829
Net change in endowment investments	(212,055)	(324,895)	120,144	(416,806)
Endowment investments at:				
Beginning of year	1,980,760	2,856,193	1,624,856	6,461,809
End of year	\$ 1,768,705	2,531,298	1,745,000	6,045,003
Investments by type of fund				
Donor-restricted "true" endowment	\$ (26,452)	2,531,298	1,745,000	4,249,846
Board-designated "funds functioning as endowment"	1,795,157	—	—	1,795,157
Total – as above	\$ 1,768,705	2,531,298	1,745,000	6,045,003



Changes in the fair value of the University endowment investments and net assets by type of fund were as follows for the fiscal year ended June 30, 2015:

	2015			
	Unrestricted	Temporarily restricted	Permanently restricted	Total
Changes in the fair value of endowment investments				
Investment return:				
Endowment yield (interest and dividends)	\$ 22,533	51,025	496	74,054
Net appreciation (realized and unrealized) on investments	61,764	98,094	958	160,816
Total investment return	84,297	149,119	1,454	234,870
Endowment payout	(169,002)	(220,553)	(1,880)	(391,435)
Net investment return	(84,705)	(71,434)	(426)	(156,565)
Other changes in endowment investments:				
Gifts and pledge payments received in cash	—	1,676	92,966	94,642
Transfers to create funds functioning as endowment	55,296	—	—	55,296
Other changes	286	(8,694)	16,590	8,182
Total other changes in endowment investments	55,582	(7,018)	109,556	158,120
Net change in endowment investments	(29,123)	(78,452)	109,130	1,555
Endowment investments at:				
Beginning of year	2,009,883	2,934,645	1,515,726	6,460,254
End of year	\$ 1,980,760	2,856,193	1,624,856	6,461,809
Investments by type of fund				
Donor-restricted "true" endowment	\$ (1,457)	2,856,193	1,624,856	4,479,592
Board-designated "funds functioning as endowment"	1,982,217	—	—	1,982,217
Total – as above	\$ 1,980,760	2,856,193	1,624,856	6,461,809



(b) *Medical Center Endowment*

Changes in the fair value of the Medical Center endowment investments and net assets by type of fund were as follows for the fiscal year ended June 30, 2016:

	2016			
	Unrestricted	Temporarily restricted	Permanently restricted	Total
Changes in the fair value of endowment investments				
Investment return:				
Endowment yield (interest and dividends)	\$ 16,383	737	—	17,120
Net depreciation (realized and unrealized) on investments	(34,742)	(3,162)	—	(37,904)
Total investment return	(18,359)	(2,425)	—	(20,784)
Endowment payout	(44,622)	(4,229)	—	(48,851)
Net investment return	(62,981)	(6,654)	—	(69,635)
Other changes in endowment investments:				
Gifts and pledge payments received in cash	—	—	10	10
Withdrawal to finance capital expenditures	(50,000)	—	—	(50,000)
Other changes	2,939	487	—	3,426
Total other changes in endowment investments	(47,061)	487	10	(46,564)
Net change in endowment investments	(110,042)	(6,167)	10	(116,199)
Endowment investments at:				
Beginning of year	914,479	73,568	8,092	996,139
End of year	\$ 804,437	67,401	8,102	879,940
Investments by type of fund				
Donor-restricted "true" endowment	\$ —	67,401	8,102	75,503
Board-designated "funds functioning as endowment"	804,437	—	—	804,437
Total – as above	\$ 804,437	67,401	8,102	879,940

Included in board-designated "funds functioning as endowment" are \$213,898 of net assets that are separately invested by the Medical Center.



Changes in the fair value of the Medical Center endowment investments and net assets by type of fund were as follows for the fiscal year ended June 30, 2015:

	2015			
	Unrestricted	Temporarily restricted	Permanently restricted	Total
Changes in the fair value of endowment investments				
Investment return:				
Endowment yield (interest and dividends)	\$ 40,491	907	—	41,398
Net appreciation (depreciation) (realized and unrealized) on investments	(13,703)	1,879	—	(11,824)
Total investment return	26,788	2,786	—	29,574
Endowment payout	(43,486)	(4,095)	—	(47,581)
Net investment return	(16,698)	(1,309)	—	(18,007)
Other changes in endowment investments:				
Gifts and pledge payments received in cash	—	—	10	10
Transfers to create funds functioning as endowment	32,000	—	—	32,000
Withdrawal to finance capital expenditures	(21,332)	—	—	(21,332)
Other changes	(1,187)	409	—	(778)
Total other changes in endowment investments	9,481	409	10	9,900
Net change in endowment investments	(7,217)	(900)	10	(8,107)
Endowment investments at:				
Beginning of year	921,696	74,468	8,082	1,004,246
End of year	\$ 914,479	73,568	8,092	996,139
Investments by type of fund				
Donor-restricted "true" endowment	\$ —	73,568	8,092	81,660
Board-designated "funds functioning as endowment"	914,479	—	—	914,479
Total – as above	\$ 914,479	73,568	8,092	996,139

Included in board-designated "funds functioning as endowment" are \$221,768 of net assets that are separately invested by the Medical Center.



(c) *MBL*

Changes in the fair value of the MBL endowment investments and net assets by type of fund were as follows for the fiscal year ended June 30, 2016:

	2016			
	Unrestricted	Temporarily restricted	Permanently restricted	Total
Changes in the fair value of endowment investments				
Investment return:				
Endowment yield (interest and dividends)	\$ 91	651	—	742
Net depreciation (realized and unrealized) on investments	(327)	(2,324)	—	(2,651)
Total investment return	(236)	(1,673)	—	(1,909)
Endowment payout	(617)	(3,629)	—	(4,246)
Net investment return	(853)	(5,302)	—	(6,155)
Other changes in endowment investments:				
Gifts and pledge payments received in cash	—	—	413	413
Other changes	(250)	242	—	(8)
Total other changes in endowment investments	(250)	242	413	405
Net change in endowment investments	(1,103)	(5,060)	413	(5,750)
Endowment investments at:				
Beginning of year	10,288	19,834	51,891	82,013
End of year	\$ 9,185	14,774	52,304	76,263
Investments by type of fund				
Donor-restricted "true" endowment	\$ —	14,774	52,304	67,078
Board-designated "funds functioning as endowment"	9,185	—	—	9,185
Total – as above	\$ 9,185	14,774	52,304	76,263



Changes in the fair value of the MBL endowment investments and net assets by type of fund were as follows for the fiscal year ended June 30, 2015:

	2015			
	Unrestricted	Temporarily restricted	Permanently restricted	Total
Changes in the fair value of endowment investments				
Investment return:				
Endowment yield (interest and dividends)	\$ 112	786	—	898
Net appreciation (realized and unrealized) on investments	724	1,546	—	2,270
Total investment return	836	2,332	—	3,168
Endowment payout	(328)	(1,757)	—	(2,085)
Net investment return	508	575	—	1,083
Other changes in endowment investments:				
Gifts and pledge payments received in cash	—	—	1,782	1,782
Other changes	24	87	1	112
Total other changes in endowment investments	24	87	1,783	1,894
Net change in endowment investments	532	662	1,783	2,977
Endowment investments at:				
Beginning of year	9,755	19,172	50,108	79,035
End of year	\$ 10,287	19,834	51,891	82,012
Investments by type of fund				
Donor-restricted "true" endowment	\$ —	19,834	51,891	71,725
Board-designated "funds functioning as endowment"	10,287	—	—	10,287
Total – as above	\$ 10,287	19,834	51,891	82,012

(d) *Interpretation of Relevant Law*

The "Uniform Prudent Management of Institutional Funds Act" (UPMIFA) was enacted in the state of Illinois in 2009. Although UPMIFA does not preclude the University from spending below the original gift value of donor-restricted "true" endowment funds, for accounting and reporting purposes, the University and Medical Center classify as permanently restricted net assets the historical value of donor-restricted "true" endowment funds, which includes (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) changes to the permanent endowment made in accordance with the direction of the applicable donor gift instrument. The remaining portion of the donor-restricted "true" endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure in a manner consistent with the standard of prudence prescribed by UPMIFA.



(e) *Endowment Payout*

Approximately 97% of the University, Medical Center, and MBL endowment is merged into one investment pool referred to as the Total Return Investment Pool (TRIP). The University utilizes the total return concept in allocating endowment income from TRIP. In accordance with the University's return objective, between 4.5% and 5.5% of a 12-quarter moving average of the fair value of endowment investments lagged by one year, is available each year for expenditure in the form of endowment payout. The payout percentage, which is set each year by the Board with the objective of a 5% average payout over time, was 5.5% for the fiscal years ended June 30, 2016 and 2015. Periodically, the University's Board will adjust the endowment payout to fund specifically approved strategic initiatives.

If endowment income received is not sufficient to support the total return objective, the balance is provided from capital gains. If income received is in excess of the objective, the balance is reinvested in the endowment.

The endowment payout is comprised of the TRIP formula payout, payout from separately held investments, as well as special payouts for the funding of Alumni Relations and Development and University-wide strategic initiatives as follows:

	University	Medical Center	MBL	Consolidated	2015 Consolidated
TRIP formula payout	\$ 336,157	39,571	4,246	379,974	360,790
Payout from separately invested endowment	2,966	9,280	—	12,246	11,848
Special payouts:					
Alumni Relations and Development	21,055	—	—	21,055	20,245
Strategic initiatives	21,513	—	—	21,513	21,482
Operational support	33,680	—	—	33,680	26,736
Total	\$ 415,371	48,851	4,246	468,468	441,101

(f) *Funds with Deficiencies*

From time to time, the fair value of assets associated with individual donor-restricted "true" endowment funds may fall below the level that the donor or UPMIFA requires to be retained as a fund of perpetual duration. Deficiencies of this nature are reported in unrestricted net assets, which, as of June 30, 2016 and 2015, amounted to \$26,452 and \$1,457 respectively.

