An Inside Look at The Chronicle’s 2015 Annual Study of Endowments

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Endowments Show Strong Gains — and Provoke Controversy

A Chronicle of Philanthropy survey of more than 230 nonprofit endowments shows growth in assets, which are being used to launch dramatic new projects and better prepare balance sheets for the future. The growth is being fueled not just by a booming stock market, but by aggressive fundraising efforts as well.

But not all is rosy with endowments. Experts warn of inflated expectations of stock market performance over the long haul. And Congress is growing increasingly uneasy with the swelling — and untaxed — endowments at many universities.

Meanwhile, many endowments are resisting heightened pressure to divest their holdings of “sin” investments like fossil fuels. And for all the talk of impact investing, most endowments remain wary that it will not produce strong enough returns to maintain their spending power.

Learn about these important trends in this special report, and find more detailed data about our endowment study in an interactive that allows you to sort information to suit your needs. Go to philanthropy.com/interactives/endowments.
The financial crisis had a way of upending the strategic plans of charities, and the Victoria Theatre Association was not spared. The Dayton, Ohio, charity built an $88-million performing-arts center 12 years ago as a companion to two other arts venues, including the historic but aging Victoria Theatre. Sales of condos and commercial space in an adjoining tower were expected to yield enough money for an endowment to support the upkeep of facilities, but the real-estate crash in 2008 left the endowment far short of projections.

By 2012, the association estimated it needed $1.5-million a year just for upkeep of the buildings, far more than its annual budget provided.

Major donors, impressed by the personal contributions of the board and staff, stepped up, too.

Ricia Ballas, the association’s vice president for development, says the endowment has now grown to more than $23 million and that anticipated gifts may push it past the $30-million goal within six to eight months.

“We haven’t had anyone say no,” Ms. Ballas says. “Donors truly appreciate the fact that we’re planning for the future.”

Much of the media coverage about endowments focuses on investment returns at big institutions. But smaller charities can often grow their endowments faster through fundraising.

And fundraising experts say now is a terrific time to solicit endowment gifts. Markets have been strong in recent years, and that provides appreciated assets for donations. The sting of the most recent recession can sometimes serve as a rallying cry.

“Everyone remembers how hard that period was — the board, the donors, the clients,” says Diana Newman, a fundraising consultant with Benefactor Group, in Columbus, Ohio. “They’re thinking, ‘Now let’s make sure we have that endowment behind us so that when the next dip comes it won’t have such an impact.’ ”

By Ben Gose and Peter Olsen-Phillips

GOING UP - An endowment campaign is raising millions for the upkeep of the Schuster Performing Arts Center in Dayton, Ohio

ANDY SNOW

“They want to see their endowment gifts have impact, and that’s what we’re doing.”

By 2012, the association estimated it needed $1.5-million a year just for upkeep of the buildings, far more than its annual budget provided.

It was time to get serious about the neglected endowment. The association set a goal to more than triple its value, to $30 million. All 23 board members contributed, along with all 65 full-time staff members and two-thirds of the part-time staff. The staff gave nearly $103,000 — enough to earn a naming right for the green room.

By Ben Gose and Peter Olsen-Phillips

Boom Time for Endowment Giving

Big charities aren’t the only ones bouncing back. This is a great time for smaller groups to increase their assets — by fundraising.

By Ben Gose and Peter Olsen-Phillips

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BIG GAINER
The Chronicle’s annual survey of endowments shows that many of them are growing fast as the economic recovery continues. The median increase in fiscal year 2014 fair market value was 11 percent — up from 9 percent in 2013 — among the 128 organizations on both surveys. The Jewish National Fund’s endowment, which jumped a remarkable 1,900 percent in 2014, was the biggest gainer, and it may land on top again for the current year. The charity’s endowment grew from $4 million to $80 million last year, and it has already doubled, to $160 million, so far in 2015.

The seeds of that growth were planted around 2002, when a $10,000 check arrived from John and Dora Boruchin in response to a mail solicitation. Mr. Boruchin, who, along with his wife, survived the Holocaust, had vowed as a young man to leave money to the state of Israel if he ever accumulated wealth. “We were exactly what he was looking for,” says Matt Bernstein, the fund’s chief planned-giving officer.

Mr. Boruchin died in 2012 and Ms. Boruchin died in 2014, leaving the fund more than $200 million in their estates, most of which ended up in the fund’s endowment. The fund honored the donors this year by creating the $100-million JNF Boruchin Israel Education Advocacy Center to promote and develop Zionist education. Mr. Bernstein says the growing prominence of that center is resonating with other donors and may lead to additional large endowment gifts to the Jewish National Fund in the future.

“This has enabled us to talk to some people about some very significant estates,” Mr. Bernstein says. “They want to see their endowment gifts have impact, and that’s what we’re doing.”

“An endowed gift puts us in position to keep your name involved in good projects in perpetuity.”

Fundraising experts say the charity is taking the right approach. “The old mode was just to use the income from unrestricted endowment as part of your income stream each year,” Ms. Newman says. “But we’re suggesting that organizations use endowment dollars for specific things so that then they can talk about it to other donors. If you can say what you’re doing with it, you’re much more likely to get new endowment gifts.”

Some organizations are boosting their endowments without relying on investment returns or fundraising. The Western University of Health Sciences, founded in 1977 in Pomona, Calif., is a relative newcomer in higher education. The university has benefited from strong demand for its programs, which include osteopathic medicine, veterinary medicine, nursing, and pharmacy. By 2010 the university had accumulated major cash reserves. It started four new programs that year, and the board decided that once the first class of students had made it to graduation, the university would move some of its reserves to the endowment, says Kevin Shaw, the chief financial officer. That transfer hit this year — and explains almost all of the $10-million increase in the university’s endowment, which rose in value to $25 million.

Mr. Shaw expects fundraising to fuel the next leg of growth. The university’s oldest graduates are only in their 50s and 60s, an age when they might start considering a significant gift. “We’ll start to see some major gifts come in from our alumni base over the next several years,” Mr. Shaw says.

ENDOWMENT PITCH
For community foundations, the urgency to add to their endowments is often just as great as at traditional charities. At many community foundations, donor-advised funds make up the bulk of assets, but money often churns through those grant-making vehicles, which can create an unstable business model for the foundation.

When a longstanding family-owned business sold this year in the Birmingham, Ala., area, the selling family came to the Community Foundation of Greater Birmingham eager to make a donation that would help local citizens now and in the future. It was a natural opening for the community foundation to pitch an endowment gift — and the family liked the idea.
The family (which has asked to remain anonymous) structured the gift as a donor-advised fund but also as an endowment gift. The contribution made up the vast majority of the $66 million in endowment donations received by the community foundation so far this year, says Erin Stephenson, vice president for development, and helped raise the endowment’s value to $170 million.

“It was a way for us to say, to the extent that your family wants to be involved, you can be in the driver’s seat,” Ms. Stephenson says. “But if for some reason your family isn’t able to play that role, an endowed gift puts us in position to keep your name involved in good projects in perpetuity.”

The CityArchRiver 2015 Foundation in St. Louis recently created an endowment that it believes will strengthen its efforts today and in the long run. As part of its efforts to revitalize the museum and grounds surrounding the Gateway Arch, the foundation has socked away $19 million in an endowment even while raising $221 million in donations for construction. Maggie Hales, president of the six-year old organization, says she thinks the foundation can hit its $29-million endowment goal by the end of the year. Those funds will fulfill a commitment CityArchRiver made to the National Park Service to help maintain the new infrastructure around the arch.

The project includes a renovated museum and a new grassy park that extends over the interstate to connect the city and the monument. When the project is complete in 2017, Ms. Hales says, CityArchRiver plans to become a conservancy and continue to grow the endowment. “That’s when the real heavy lifting is going to come,” she says. “We’ll need to make the case for the endowment and why it matters to a broader audience.”

How to Invest?

*The Chronicle’s* endowment survey suggests that size matters when it comes to investment strategies. Based on data from 233 respondents, we compared the share of dollars that organizations with varying endowment sizes put into stocks, private-equity funds, and other investments.

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A Divestment Showdown

Even as America’s biggest institutions promote efforts to curb climate change, they resist calls to sell their fossil-fuel stocks.

By Ben Gose
At a New York news conference in September that outlined the global movement to get institutions and individuals to divest from fossil-fuel stocks, the speakers painted a picture of exponential growth.

In just one year, the assets pledged to the movement had increased 50 times, to $2.6-trillion, driven by commitments from huge investors like the California Public Employees’ Retirement System and the Government Pension Fund of Norway. Leonardo DiCaprio was there to lend star power, stating that his foundation, like the others that had signed on, would ditch oil, gas, and coal stocks and invest in clean energy.

But missing from the news conference — and the divestment pledge — were nearly all of the largest foundations in the United States. The Rockefeller Brothers Fund signed on 14 months ago, but no others on the Foundation Center’s list of the 100 biggest grant makers by asset size has since joined the movement.

The lack of action by major foundations, particularly those that are aggressively addressing climate change through their grant making, has puzzled and at times infuriated advocates for the movement.

Marc Gunther, a veteran journalist who edits the “sustainable business” section of The Guardian newspaper, called out the William and Flora Hewlett Foundation and the David and Lucile Packard Foundation after their presidents jointly wrote an opinion piece in The Chronicle in April that described climate change as “the defining issue of the day” and “a problem that demands action now.” Neither foundation has divested its fossil-fuel stocks.

“Foundations remain reluctant to own up to what they own,” Mr. Gunther wrote.

Foundations aren’t the only group giving the movement the cold shoulder. The biggest university endowments have also generally refused to budge — and they’ve had to deal with protesting students. Harvard students blocked access to President Drew Faust’s office in April to protest the university’s investments in fossil fuels. Harvard administrators took their laptops to coffee shops to do their work, but they didn’t make any changes to the $36-billion endowment.

The big endowments and foundations list plenty of reasons for not joining the movement. Some complain that they’re too entrenched with outside investment managers who are unwilling to narrow their pool of investment opportunities. A recent study by a visiting professor at the California Institute of Technology — albeit one financed by the Independent Petroleum Association of America — found that divestment at big endowments could be costly. Harvard would lose out on $100 million a year, he argued.

Critics of the research point out that Harvard has likely lost far more than that by holding on over the past year. Oil, natural gas, and coal stocks have plummeted.

Other foundations argue that divestment is a sideshow that won’t make much real difference. The Bill & Melinda Gates Foundation quietly reduced its holdings in fossil-fuel stocks by two-thirds during 2014, The Seattle Times reported last month, but the foundation has downplayed divestment in public comments. In an interview in the November issue of The Atlantic, Bill Gates says that by pushing divestment, “you’re taking whatever desire people have to solve this problem and kind of using up their idealism and energy on something that won’t emit less carbon.”

William MacAskill, an expert on the extreme brand of philanthropy known as “effective altruism” and an associate professor of philosophy at Oxford University, argues that divestment could actually cause harm by artificially driving down prices of fossil-fuel stocks, presenting opportunities to people who don’t have ethical qualms about owning ExxonMobil. “Ethical” investors, he writes on The New Yorker’s website, may be transferring money to opportunists “who will likely spend it less responsibly.”

Some foundations have set an extremely high bar for divesting — one that the global threat of climate change doesn’t meet. The John D. and Catherine T. MacArthur Foundation, which in August pledged $50 million to climate change, posted a statement on its website this month that said divestment is “never to be entertained to assert policy preferences, censure, or political leverage.” The strategy should only be considered, the statement said, when “investment descends to the level of morally abhorrent activity,” such as genocide, apartheid, or slavery.
Officials at Packard declined to comment on their reasons for not divesting, but a spokeswoman pointed to a statement about its investment philosophy that says the foundation is managed externally with no screens.

Hewlett also declined interview requests, but in a statement said that he has eliminated coal from its separately managed accounts. This year, “to reflect the foundation’s extraordinary commitment to mitigating climate change,” Hewlett decided that it would make no future investments in private partnerships primarily involved in oil and gas drilling.

Clara Miller, president of the F.B. Heron Foundation, says her foundation “is on the side” of the divest movement but has decided not to join for now, as it debates its strategy. For some fossil-fuel sectors, notably coal, the outlook is so bleak that divestment may no longer be the best strategy, she says. “It really is in need of transition plan rather than a punishment plan,” she says.

Heron is considering investment in reclamation companies in states like West Virginia and Ohio that might improve the environment while providing jobs to displaced miners.

“It’s an opportunity we’re looking at, but it’s not fully formed yet,” Ms. Miller says.

Ms. Dorsey points to recent wins, such as the $4.3-billion Children’s Investment Fund Foundation, based in London, which decided to join Divest-Invest in September. And she notes with pride that Peabody Energy, the world’s biggest private-sector coal company, has, under pressure from New York’s attorney general, listed the divest movement as a threat to its business.

She’s hopeful that more large U.S. foundations will eventually sign on. “We’re on the right side of history,” Ms. Dorsey says. “We’ll put money on the solutions, rather than drive the problems we’re asking our grantees to clean up.”

“FOUNDATIONS REMAIN RELUCTANT TO OWN UP TO WHAT THEY OWN.”

Some foundations and endowments are committed to working with companies to make the transition to cleaner fuel technology. Massachusetts Institute of Technology rejected demands that it divest in October, calling the strategy “a dramatic public disengagement” that is incompatible with its plan to collaborate with companies on research.

Ellen Dorsey, executive director of the Wallace Global Fund, is the founding force behind Divest-Invest Philanthropy, a network of foundations that have pledged to get out of fossil-fuel stocks within five years and put 5 percent of their assets into clean-fuel technology.

She dismisses the notion that the divest movement is failing in the United States, pointing to a total of 115 foundations that have signed on, up from 17 when the effort started nearly two years ago. “Collectively, this movement has accelerated at a pace and a scale that is unprecedented,” Ms. Dorsey says.
Impact investing is all the rage — on Wall Street. Foundations, it seems, haven’t yet fully bought into the idea.

The term is a marketer’s dream — “impact investing” has caught on in a way that terms like “socially responsible investing” never did. Financial firms, including BlackRock, Morgan Stanley, and AXA, are responding with a slew of new products.

Bain Capital has hired Deval Patrick, the former governor of Massachusetts, to start a social-impact line of business. Goldman Sachs is buying Imprint Capital, an innovator in creating investments that deliver social as well as financial returns. Even Pope Francis has praised impact investing.

SIDESHOW FOR GRANT MAKERS

But outside of a dozen or so foundations, such as the F.B. Heron and KL Felicita foundations, which have made impact investing a priority, the practice mostly remains a sideshow among grant makers.

In The Chronicle’s endowment survey, only 36 of 238 respondents, or 15 percent, reported using impact investments. A survey of large foundations conducted earlier this year by the Center for Effective Philanthropy found higher numbers: Twenty-six of 64 responding, or 41 percent, said they were engaged in impact investing. But the responding foundations told the center they were devoting a median of only 2 percent of endowment assets to the strategy.

“We’ve got a lot of folks who say that they’re doing it, but the dollars are small,” says Phil Buchanan, the center’s president.

“The folks who are leading the way on this are more likely to be family offices and wealthy individuals,” says Clara Miller, Heron’s president. “Foundations are moving along much more slowly.”

The slow progress may be caused in part by confusion over what exactly impact investing is. The term can mean stock funds that apply environmental, social, and governance screens or program-related investments or direct investments in companies seeking a social return as well as a financial one.

NEW IRS POSITION

Some advocates for impact investing hope a recent announcement by the Internal Revenue Service will persuade a greater number of foundations to invest more of their endowment assets in ways that also further their social goals. The IRS can apply an excise tax on foundations that jeopardize endowment assets by taking big investment risks. The new IRS announcement said that a foundation that knowingly accepts a lower return on an investment that furthers its social goals would not be subject to the tax.

It’s too early to say whether the announcement will make a difference. Some foundations may not be worried about a tax on imprudent investments; they may simply think many impact investments don’t provide an adequate financial return. As noted elsewhere, many chief investment officers are fretting over whether they’ll be able to achieve the long-term returns that are needed to maintain their endowment’s value.
The Kresge Foundation received considerable press attention in September when it announced that by 2020 it would commit $350 million, 10 percent of its current corpus, to impact investments. But the fine print got buried in the news release.

According to Robert Manilla, Kresge’s chief investment officer, $150 million will go out via program-related investments, which aren’t endowment investments at all — they count toward the foundation’s 5 percent minimum spending rate under federal law. Another $150 million will be guarantees, in which the foundation uses its endowment as a backstop for, say, non-profit borrowers who would have trouble obtaining a loan otherwise. The guarantees put some endowment dollars at risk, but the endowment can also invest those dollars in conventional assets at the same time.

Only $50 million, or less than 1.5 percent of the endowment, is targeted for mission-related investments. Current areas of investment include affordable housing, health care for low-income people in Detroit, and an equity stake in Sustainable Insight Capital Management, a New York firm that uses environmental, social, and governance screens.

One reason Kresge is keeping the equity portion of its impact-investment portfolio small for now is the limited number of opportunities available, Mr. Manilla says. Although he hopes to expand the dollars committed to mission investments in the future, all such investments must meet the foundation’s return objectives and its programmatic goals, he says. Certain fields, such as health care and education, are more likely than others, such as the arts and human services, to offer attractive investment opportunities, he says.

**SOLUTIONS AND MONEY?**

Mr. Buchanan, of the Center for Effective Philanthropy, says impact investing may never have the reach that its most ardent advocates envision.

“There are a lot of things that you can only really work on through good, old-fashioned philanthropy,” Mr. Buchanan says. “The rhetoric would suggest that you can solve every social problem while making a ton of money, but that’s obviously not true. Identifying the opportunities isn’t easy.”

Smaller foundations that rely on outsiders for investment management rarely make direct social investments on their own. They often rely on investment advisers to recommend funds that apply screens, such as positive environmental, social, and governance standards or negative screens for tobacco or fossil fuel companies.

Federal Street Advisors works with 15 foundations with assets of roughly $830 million. Five of the foundations, with assets of $230 million, hold significant assets that are invested using environmental, social, and governance strategies.

“It’s a matter of helping clients align their portfolios with their values and mission,” says Mark Peters, a principal at Federal Street. “Each investment committee will make its own path as it looks toward that end goal.”

Applying screens to stocks has been around for decades; it’s not as sexy as a direct impact investment in a promising young company that aspires to do good.

But many experts believe that impact investing will begin to make a real difference only if large public companies begin to take sustainability standards seriously. Kresge, Heron, and several other foundations have made grants to support the Sustainability Accounting Standards Board, a nonprofit that is developing a list of sustainability issues unique to different industries. Public companies would report progress against those standards in mandatory filings required by the Securities and Exchange Commission.

Ms. Miller, Heron’s president, serves on the nonprofit’s board along with a number of financial heavyweights, including Michael Bloomberg, the businessman and former mayor of New York, and Mary Schapiro, the former chairwoman of the SEC.

“This is not a tree-hugging board,” Ms. Miller says. “These are people with a lot of business sense, and they understand that these things are material to investors.”

In 2014, shortly after the provisional release of standards for the technology and communication sector highlighted work-force diversity as an issue, large companies including Google and Facebook voluntarily revealed that roughly 90 percent of their employees were white or Asian. The companies immediately responded by starting efforts to create a more diverse work force.

William Burckart, a philanthropy consultant who specializes in impact investing, says efforts like Sustainability Accounting Standards Board have a long way to go but are likely to make a lasting contribution.

“The better clarity we get around impact, the more we’ll understand which investments are — and aren’t — performing for society,” Mr. Burckart says. “The DNA that needs to be in place for this new heart to start pumping is just coming into being.”
College Endowments Are Flourishing Again — and Critics Are Taking Note

By Ben Gose

There’s something about a nearly $35 billion endowment that just keeps Congress coming back. A decade ago, as lawmakers eyed legislation to require the richest colleges to spend more from their endowments, the Ivies and their counterparts bought time by voluntarily increasing financial aid for undergraduates. Then the financial crisis hit, the endowments sank in value, and the debate quieted down.

Now, after six years of strong returns, college endowments are flush again, with Harvard University still leading the pack at $35.3 billion. And they’re ripe for another round of attacks.

Victor Fleischer, a professor of law at the University of San Diego, kicked off the endowment-bashing this year with an August opinion piece in The New York Times. He opened with a startling statistic: Yale University paid about $480 million to its private-equity managers in 2014, nearly three times the amount that the endowment paid out for tuition assistance, fellowships, and prizes.

That column got the attention of Malcolm Gladwell, the best-selling author, who took to Twitter and National Public Radio to complain about how taxpayers were subsidizing the income of hedge funds and private-equity funds through elite-college endowments.

“I was going to donate money to Yale,” he tweeted. “But maybe it makes more sense to mail a check directly to the hedge fund of my choice.”

Mr. Gladwell also called attention to research by the Nexus Research and Policy Center, which found in an April report that taxpayer subsidies for the elite private institutions dwarf subsidies for public institutions when you consider that endowments aren’t subject to tax. The report found a per-student subsidy at Princeton University of more than $100,000, compared with a per-student subsidy at Rutgers University, a nearby public institution, of just $12,000.

Universities like Harvard, Yale, and Princeton argue that their large endowments are important because endowment spending accounts for a big portion of their budgets. They note that much of their endowments is typically restricted for a specific purpose. And they point to strong long-term endowment returns as evidence that the investing fees have been worth the cost.

“Of course there’s income inequality,” says John Griswold, executive director of the Commonfund Institute, the research arm of Commonfund, which manages college endowments. “To say that a small number of wealthier colleges should try to solve that is utter nonsense.”

BIPARTISAN CONCERNS

At a congressional hearing in October, House Republicans criticized the way wealthy colleges were spending their endowments. Representative Tom Reed of New York, a Republican, said he was drafting a bill to require universities with endowments of more than $1 billion to spend more on students, which could include reducing or even eliminating tuition, or face tax penalties. He also said he’d like to change the tax code so that restricted gifts to universities receive fewer tax benefits than unrestricted gifts.

In a statement provided to The Chronicle, Mr. Reed said the greater endowment spending would free many students from crippling student-loan debt.

“It is a disservice to the next generation of Americans to continue to allow them to struggle when we could so easily address the problem of out-of-control costs by making simple changes to our tax code,” he said.
An often-cited benefit of endowments is the cushion they provide during downturns. But Brian Galle, a professor at Georgetown University Law Center who studies endowments and taxation, testified at the hearing that Harvard has taken its “rainy day” account to an absurd extreme. The endowment could cover Harvard’s entire budget for 12 years, Mr. Galle said.

“We can make better use of the money now than the future can,” Mr. Galle said in an interview. “By not spending the money now, we’re giving up social-investment returns that are bigger than the dollar returns that organizations are getting by investing their money.”

**SPILLOVER EFFECT**

Mr. Fleischer thinks the time may be ripe for legislation, with Republicans concerned about college costs and Democrats concerned about concentrated wealth and the role that tax-exempt colleges play in padding the income of hedge-fund managers.

“There’s support from both the left and the right for some kind of legislation that would refocus attention on the true beneficiaries of the endowment — the students and the faculty,” Mr. Fleischer says. “But you can’t underestimate the lobbying power of the universities or Wall Street.”

Any legislation targeting the wealthy private colleges always runs the risk of having spillover effects that have an impact on other endowments, including at charities. Those groups will watch any legislation with trepidation, says Diana Newman, a consultant specializing in endowment fundraising.

“For the great majority of organizations, the endowment is not some huge wad of money that they’re sitting on,” Ms. Newman says. “It’s focused, and they’re using it pretty wisely and depending on it.”
Investment Returns: Time to Lower Expectations

Grant makers anticipating 8 or 9 percent may be disappointed.

By Ben Gose

The typical private foundation anticipates long-term returns from its endowment that average more than 8 percent a year. But why should foundations expect in the future what they haven’t been able to achieve in the recent past?

The bull market of the past six years may dull the memory of the financial crisis, but a look at the trailing 10-year returns for foundations offers a case study in how challenging it is to recover from a nasty decline. The latest study by the Council on Foundations and Commonfund found that private and community foundations posted average annual returns of 6.3 percent for the 10 years ending December 2014.

The same study found that the most frequently cited long-term return objective for private foundations ranged from 8 to 9 percent.

Prognosticators say the future may look like the recent past. With bond yields at record lows, many suggest that annual returns of 6.5 to 7.5 percent on a diversified portfolio are likely. Those returns may prove satisfactory for operating charities, which can raise additional money and also decide how much they want to spend from their endowments.

But for private foundations, many of which are set up to operate in perpetuity, such returns may be a disappointment. Foundations often have no new donations coming in, and they are required by federal law to spend 5 percent of existing assets each year. Inflation and investment expenses also eat away at an endowment’s value over time.

**WALKING A ‘TIGHTROPE’**

The Commonfund report sums up the challenge foundations are facing. “If, as many economists believe, the world has entered a period of lower economic growth that will lead to correspondingly lower average investment returns, this mismatch between investment objectives and investment performance will need to be addressed,” the report says.

Robert Manilla, chief investment officer at the Kresge Foundation, figures his annual bogey is 7.5 percent — the 5 percent spending requirement, another half percent in other expenses, and 2 percent for inflation.

Mr. Manilla, reached during a break in a meeting with 20 other foundation chief investment officers, says that every one of them walks the “tightrope” of producing a high enough return to preserve the purchasing power of their endowment without adding too much risk and jeopardizing the corpus. That’s one reason that Kresge and most other foundations are only cautiously wading into impact investments — which, if implemented carelessly, could sacrifice financial return in a bid to accomplish social goals. (See the sidebar on impact investments).

“It’s hard to generate a 7.5-percent return when your cash is earning zero,” Mr. Manilla says. “We don’t have the capacity to take below-market returns in an environment where we think it’s going to be difficult enough to meet our base hurdle.”

William Jarvis, executive director at the Commonfund Institute, the research arm of Commonfund, which manages institutional investments, says one option for foundations that fret about earning enough on their investments is to simply abandon the desire to keep making grants forever.

“But we don’t see much of a tendency toward that,” Mr. Jarvis says. “The overwhelming number of foundations tell us that they’re trying to exist in perpetuity.”
Most Americans think nonprofits and universities amass large endowments to help them, like rainy-day funds, weather tough economic times without sacrificing valuable programs. Unfortunately, that doesn’t seem to be the case for many institutions.

Research has shown that the largest nonprofits and universities tend not to spend from their endowments in tough times, choosing instead to cut programs. Maintaining huge endowments for their own sake has become the goal for many administrators.

And those endowments benefit greatly from the tax exemption offered to all nonprofits on the assumption that such funds will be used toward a public good. But what happens when the money isn’t being used for anything at all?

Many federal and state laws seek to curb the misuse of nonprofit resources, but there are virtually no limits to the non-use of nonprofit funds. When a nonprofit makes a profit (or “surplus,” if you prefer), it has three options: spend it, give it to another nonprofit, or save it.

For some nonprofits, the process of making a profit and saving it — endowment building — is big business. It’s time to push federal policy makers to change the way the system works, by either penalizing nonprofits that hoard money or providing incentives for them to spend their endowments more quickly.

Harvard University, Yale University, and Howard Hughes Medical Institute added an average of $1.5 billion to their endowments in the last year along. At the same time, dozens of other nonprofits, including museums, hospitals, and universities, increased their endowments by hundreds of millions of dollars.
Society expects a return on its investment when it provides a subsidy to an organization. For example, Americans expect nonprofits to use such subsidies to provide goods and services that benefit the greater good.

But the very nature of a massive endowment means that those benefits to society are not being realized. Instead, the money given to a nonprofit by taxpayers simply sits in an investment account, growing ever larger. In fact, for some nonprofits, the ability to build an enormous endowment enables the organization to realize even greater profits elsewhere. That is the case with nonprofit hospitals, the majority of which use their endowments primarily to engage in tax arbitrage, whereby they borrow money at a low interest rate, thanks to their ability to issue low-interest debt, and then use that money to fund operations instead of using their endowment funds, which are earning a much higher rate of return.

To be sure, the vast majority of nonprofits do not hold giant endowments. Most food pantries and homeless shelters operate on a shoestring and seek money constantly. However, the biggest endowments are growing so fast that the federal government needs to adopt a new approach.

To curb endowment hoarding by the richest nonprofits, I suggest we tax any funds in an endowment that aren’t being used to advance the organization’s charitable mission. The value of this approach is that it respects an organization’s right to decide where it wants to spend its money. What’s more, it doesn’t force the government to introduce onerous new regulations that are costly to put in place. And it would affect only a small number of nonprofits — just those with big endowments. The sole goal is to ensure that society gets what it bargained for from nonprofit organizations.

Here’s how it would work:

First, we should eliminate the blanket income-tax exemption for nonprofits and replace it with a system akin to the business-expense deduction that applies to for-profit companies. Anything a nonprofit spent to further its charitable purpose would be deductible, including salaries, overhead, and virtually all expenses related to the organization’s mission.

Second, a standard deduction would be allowed on top of an organization’s regular expenses to permit a modicum of savings each year. (I suggest approximately $10 million a year, but more detailed economic analysis could determine a better figure.) Nonprofits often have great swings in their finances, with a banner year followed by a down year. By permitting a certain level of savings to account for these scenarios, nonprofits could make plans without the risk of incurring tax liability, and small nonprofits could save funds for a rainy day without worry.

Third, nonprofits would be allowed to save money toward a specific capital project tax free for up to five years, provided the money is actually spent on the designated capital project. That would allow nonprofits to save for new buildings or equipment or any other large capital expense that furthers their charitable missions, all without running the risk of incurring tax liability.

After that, all other profits the nonprofit kept would be subject to income taxation. The Harvards of the world would be free to build their endowments to the moon and back, but for those amounts over and above the standard deduction, if they are not going to be actively spent on a designated capital project within five years, the organization would have to pay taxes on the income.

This proposal has a clear benefit to society: No longer would the public be subsidizing the endless accumulation of endowment funds for the nation’s largest nonprofits — which, of course, isn’t the purpose taxpayers intended when they provided that advantage. But government funds would still subsidize nonprofits that spend their income toward their charitable missions.

Shaking up the current nonprofit tax system is scary, no doubt, but it has become increasingly necessary as more and more dollars get locked up in endowments rather than in promoting social good.

Michael Ryan Fricke is a lecturer of business administration at the University of Illinois at Urbana-Champaign. This piece is adapted from an article that is scheduled to appear in the St. John’s Law Review.

*By Peter Olsen-Phillips*

*The Chronicle’s* 2015 report on endowments contains information on 298 nonprofit organizations, including how 233 of those endowments are invested across eight asset classes.

To compile the information, *The Chronicle* sent surveys to 745 of the largest nonprofits in the country and 502 others, representing a wide cross-section of endowments large and small. Most of this year’s list is composed of large groups, 195 with endowments worth $100 million or more at the end of fiscal year 2014 and 101 organizations with less. (Two groups on our list did not include information on the value of their endowments in 2014.)

Much of the data on the fair market value of colleges’ endowments came from the Council for Aid to Education’s Voluntary Support of Education survey, as indicated by footnotes.

As with previous years, the largest portion of our list is colleges (85), followed by private foundations (45) and community foundations (30).

If you have comments or questions about the survey or would like to suggest a group you think we should include in future reports, send an email to research@philanthropy.com.
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