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Investment Policies and Risk Management for Community College Foundations

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About Ferguson Wellman

As of June 30, 2012

Year founded	1975
Assets under management	$3 billion
Client relationships	592
Team experience	17 investment professionals – average of 24 years in the industry
Stability	In the last 23 years – no investment professional turnover
Continuity	100 percent employee owned
Investment expertise	Managing individual asset classes and constructing balanced portfolios using individual securities
Lifelong relationships	37 years serving multi-generational families, foundations, endowments, corporations and Taft-Hartley plans

Non Profit Expertise

- Six community college foundation clients
- 56 foundation and endowment clients
- 53 board or investment committee seats served by Ferguson Wellman professionals
- Philanthropic and investment education services offered

What are Investment Guidelines and Why Are they Important?

"A document drafted between a portfolio manager and a client that outlines general rules for the manager."

- Investment goals and objectives
- Roles and responsibilities
- Allowable assets
- Asset allocation (ranges)

What are Investment Guidelines and Why Are they Important?

Additional components:

- Agreed upon risk tolerance
- Liquidity or income requirements
- Diversification requirements
- Benchmarks (how to measure success)
- Provides continuity and stability

Investment Guidelines – also Define What Can't Be Done

- Concentration risk
- Maximum position size
- Quality of assets
- Prohibited transactions
    - Leverage
    - Margin
    - Short selling
    - Derivatives
- Prohibited purchases
    - Company (never buy Procter and Gamble)
    - Industry (never buy tobacco producer)

Basic Rules for Investment Guidelines

- Clear and written for the long horizon
- Annual review by board/committee and the investment manager
- Changes only with significant circumstances
    - o Spending policy changes
    - o Asset allocation changes
- Consider addition of asset classes carefully
- Diversify, diversify, diversify
- Make sure it is appropriate for your organization

If you or your investment manager can't explain it in three sentences, don't buy it

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Spending Policies

How to Manage Them in Challenging Times

How to Build One Million Dollar Endowment

The monthly investment needed to save $1,000,000

Rate of return	10 years	20 years	30 years
4%	$6,769	$2,717	$1,436
6%	$6,072	$2,154	$991
8%	$5,430	$1,686	$667
10%	$4,841	$1,306	$439

The power of planned gifts/bequests!

How Inflation Impacts Your Distributions

With annual distributions of $100,000 and a 3 percent inflation rate

Year	Annual Withdrawal After Inflation	Total Estimated Funds You Will Have Gifted
1	$103,000	$103,000
10	$134,392	$1,180,780
20	$180,611	$2,767,649
30	$242,726	$4,900,268

At a 3 percent inflation rate, your distributions will **double** every 24 years!

Don't forget college tuition inflation rates.

Past performance is no guarantee of future results

Will the Foundation's Funds Last?

Odds money will last over a 25-year period

Stock / Bond Allocation (%)

Real withdrawal rate based on initial balance	100/0	60/40	50/50	40/60	0/100
3%	98%	99%	99%	99%	99%
4%	88%	96%	97%	98%	99%
5%	74%	77%	78%	78%	69%
6%	55%	52%	50%	47%	20%
8%	26%	14%	8%	4%	0%
10%	9%	1%	1%	0%	0%

Odds of money lasting 25 years

Source: T. Rowe Price

Monte Carlo is a simulation that produces a ranges of possible outcomes. Long-term expected annual returns for the asset classes are based on estimates, which include reinvested dividends and capital gains for a 25 year time horizon. The initial withdrawal amount is the percentage of the initial value of the investments withdrawn on the first day of the first year. In subsequent years, the amount withdrawn grows by a 3% annual rate of inflation. Taxes on withdrawals are not taken into account, nor are early withdrawal penalties. 8.789% Net returns for stocks. 5.738% Net returns for bonds

Disbursements at 5 percent or greater puts you at real risk of running out of funds

Your $1,000,000 Foundation after 15 Years

Based on withdrawal rates, 6 percent annual returns and 3 percent inflation

4% withdrawal rate

$1,292,825

6% withdrawal rate

$669,0061

8% withdrawal rate

$45,298

10% withdrawal rate

-578,466

For Most Foundations …

Plan on a sustainable withdrawal rate of no more than $40,000 per one million dollars per year

Community College Endowment Considerations

1. Base withdrawals on a rolling three-year average to smooth out market highs and lows
2. If trustee objectives include maintaining the inflation-adjusted value, withdrawals should not exceed 3.5 to 4.0 percent
3. Consider accounting for inflation-adjusted principal and making distributions only when the endowment exceeds that threshold
4. Have a written policy defining treatment of bequests
   a. All to endowment and increase the floor
   b. Some to endowment – some as current distribution

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Horizon for Foundations

How Do Current Gifts, Deferred Gifts, and Planned Gifts factor into spending?

- They don't really have any effect on the spending policy
- They do have an effect on the investment pool.
  - The larger the pool – the greater the income
- They play a large role in forecasting for future growth of the Foundation

Building Our Futures Together Major Gifts Campaign 2008-2010?

- Feasibility study done in the fall of 2008 indicated that the goal should be $7-$8 million

- Campaign kicked off in January 2009 – During one of the worst economic downturns in history

- What we found was:
  - Donors stretched to make their gifts
  - Longer pledge periods – 5 years versus 3 years
  - Lots of planned gifts were created
  - Many said "I really can't give now…….but I will make it up to you."

- Ended the campaign in July of 2010 at $10.17 million
  - Subsequent make-up gifts have raised the total to over $11 million

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Understanding the Risk and Return Framework

There is no risk free asset

Returns Vary Significantly by Decade and Assets

	Stocks	Bonds	Inflation
1920 - 1929	14.3%	6.4%	-1.4%
1930 - 1939	-0.1%	4.6%	-2.0%
1940 - 1949	9.2%	1.8%	5.4%
1950 - 1959	19.4%	1.3%	2.2%
1960 - 1969	7.8%	3.5%	2.5%
1970 - 1979	5.9%	7.0%	7.4%
1980 - 1989	17.5%	11.9%	5.1%
1990 - 1999	18.2%	7.3%	2.9%
2000 - 2009	-0.9%	8.5%	2.86%
Total	**10.1%**	**5.8%**	**2.8%**
2010 - 2011	8.5%	7.9%	2.2%

The S&P 500 Index covers 500 industrial, utility, transportation, and financial companies of the U.S. markets. The index represents about 75 percent of NYSE market capitalization and 30 percent of NYSE issues. It is a capitalization-weighted index calculated on a total return basis with dividends reinvested. (Stocks)

The Barclays Government/Credit Index measures performance of U.S. dollar denominated U.S. Treasuries, government-related, and investment grade U.S. corporate securities that have a remaining maturity of greater than or equal to 1 year. The securities have $250 million or more of outstanding face value and must be fixed rate and non-convertible. (Bonds)

The CPI Index is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. (Inflation)

Prepare to Live Through Difficult Times

Bear Markets* Will Occur

Market Bottom	Percentage Loss	Duration (in days)
June 1949	-29.6%	1111
October 1957	-21.6%	446
June 1962	-28.0%	196
October 1966	-22.2%	240
May 1970	-36.1%	543
October 1974	-48.2%	630
August 1982	-27.1%	622
December 1987	-33.5%	101
October 2002	-49.1%	929
March 2009	-56.7%	517
Average	**-35.2%**	**534**

Source: Bloomberg – based on historical daily closing values for the S&P 500 Index.

**A bear market is a prolonged period when the stock market declines by 20 percent or more.*

Prepare Trustees to Experience Difficult Times

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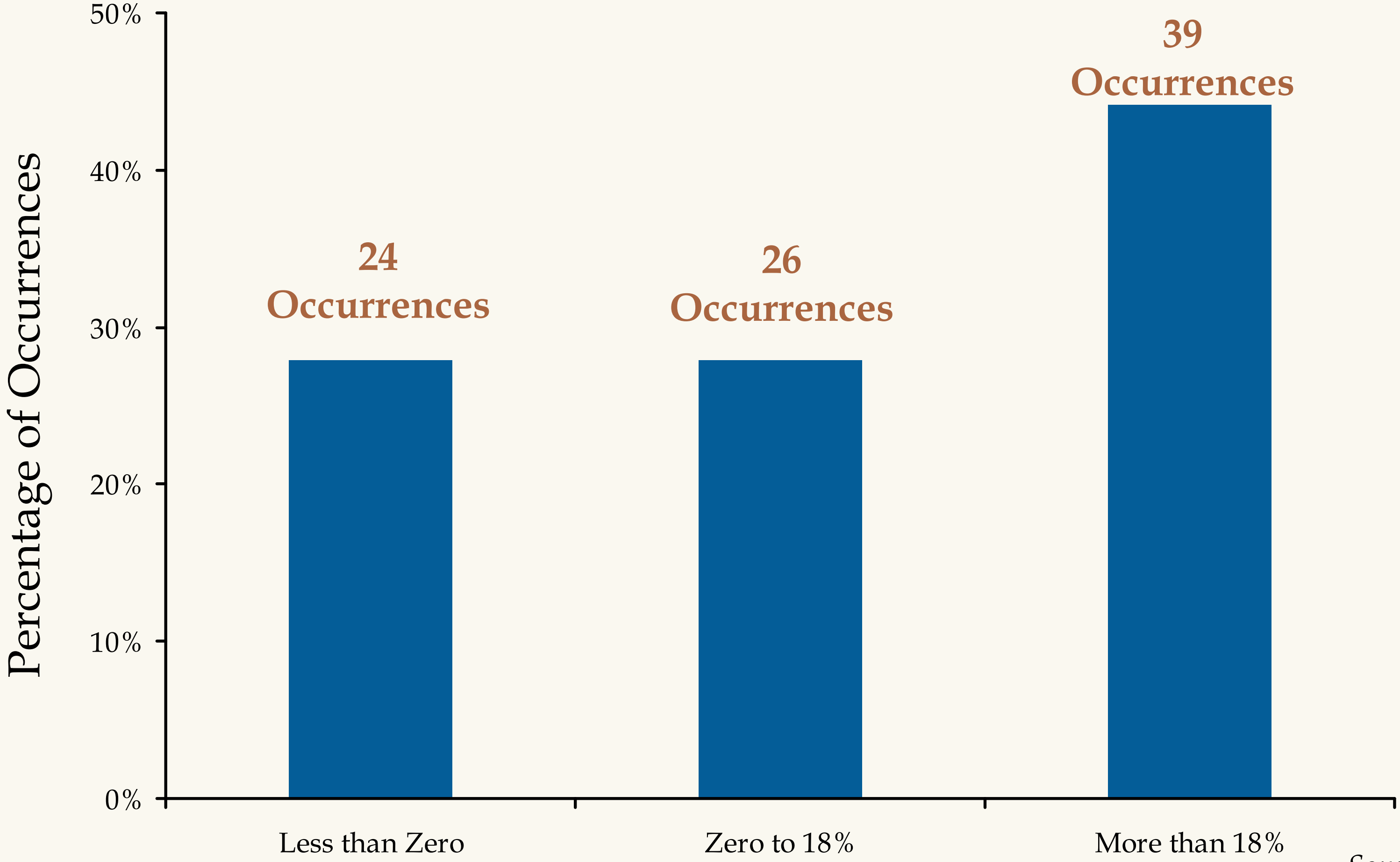
- Bear markets occur at **least** once a decade
- The drop is severe (average is **35%**)
- Bear markets can last for a **long** time

Bull Markets Outnumber Bear Markets

Stock Market Returns from 1926-2011

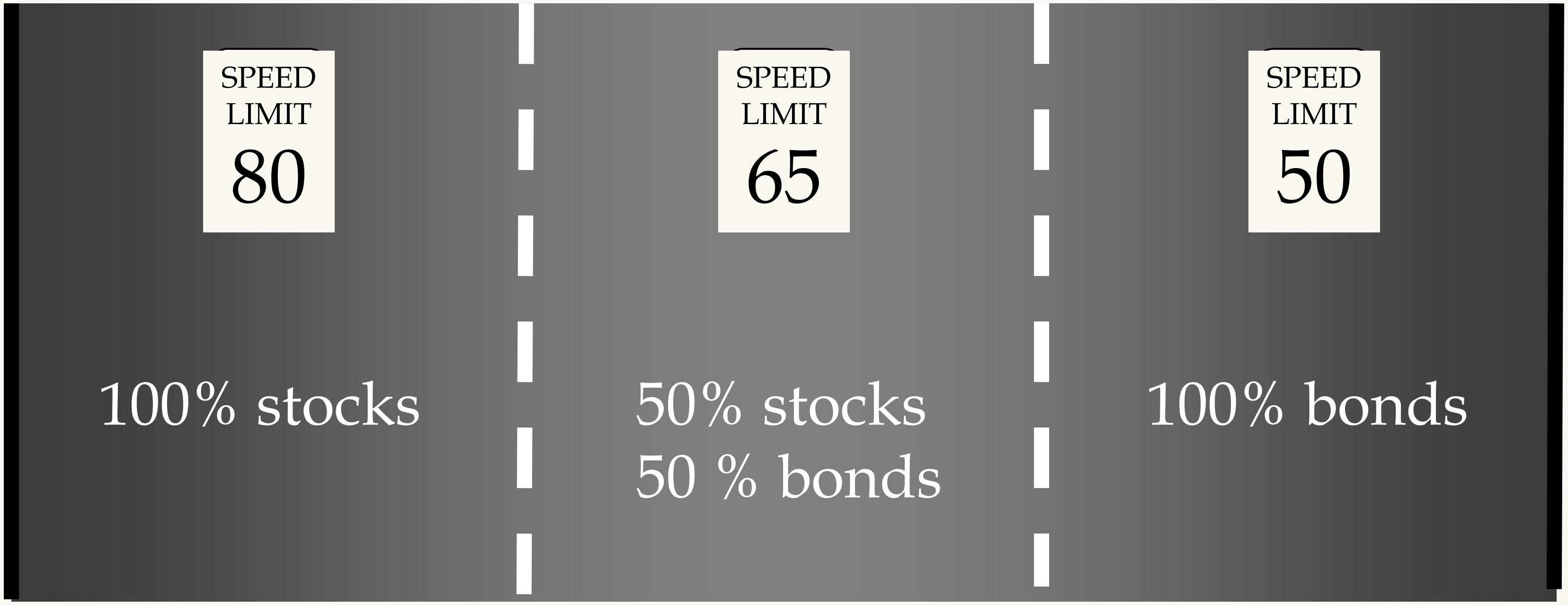


Source: Ibbotson

Based on average annual percentage returns for large-cap stocks over 86 one-year periods from 1926 to 2010, assuming reinvestment of dividends and capital gains. Large cap stocks are represented by the S&P 500.

How You Get There Matters

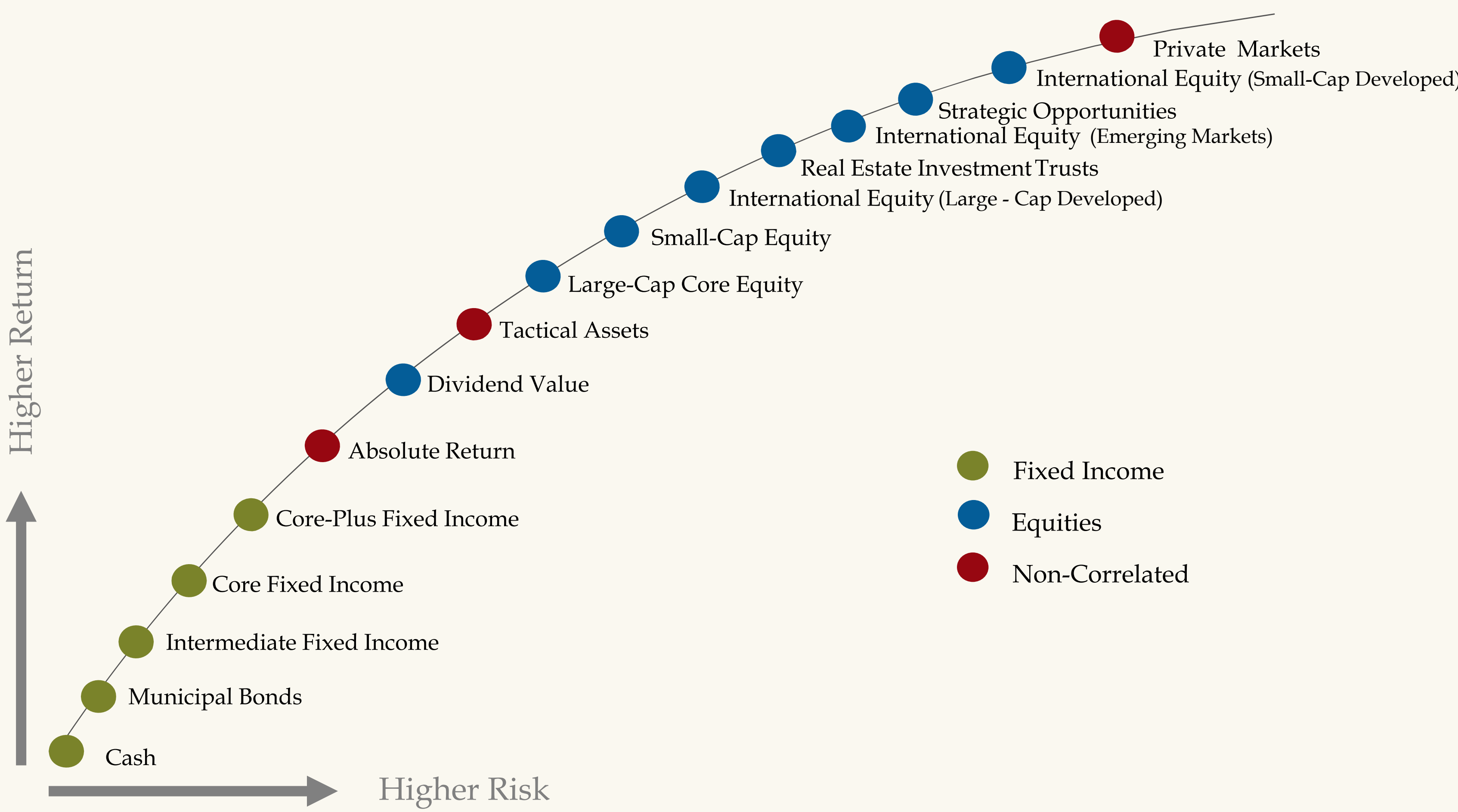
Market-induced lane switching can be dangerous and costly



You need to find the right long-term lane

Ferguson Wellman Investment Strategies

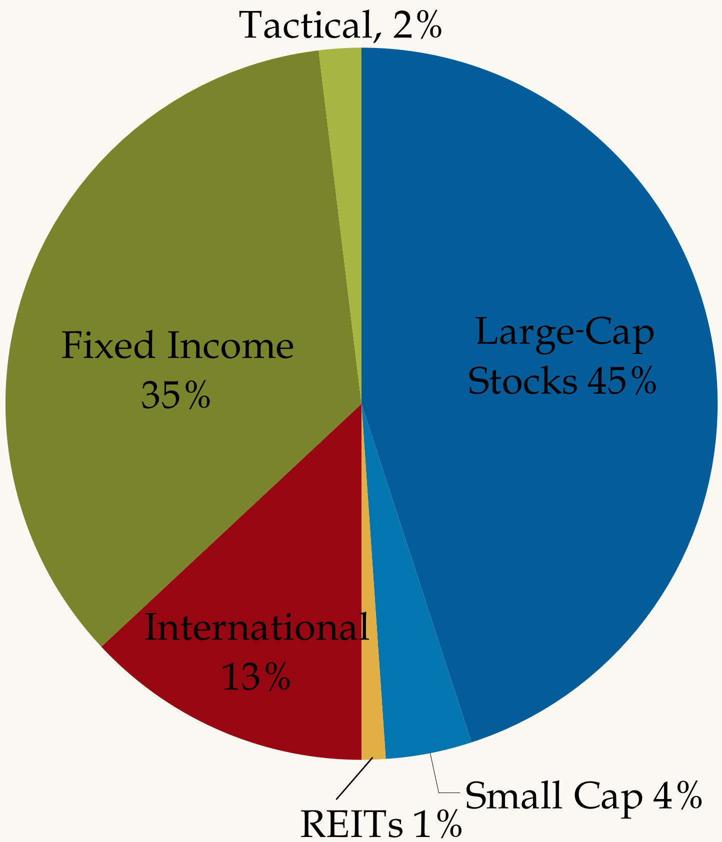
Risk versus return



Depending on a clients' investment vehicles and goals, Tactical Assets, Absolute Return and Private Markets may appear anywhere on this risk/return chart. Balanced portfolios can also be customized to meet a client's needs and so can appear any where on this chart.

Diversification Is Key to both Bull and Bear Markets

Sample Asset Allocation



Test Your Risk Tolerance on Paper First

Historical Market Information

		Large Cap	Small Cap	EAFE	Emerging	REITs	Fixed Income
Bear	**2008**	-37.0%	-33.8%	-43.1%	-54.5%	-37.7%	5.2%
Bull	**2009**	26.5%	27.2%	32.5%	74.5%	27.8%	5.9%
20-Year Annualized		9.1%	10.8%	6.2%	9.6%	11.5%	6.9%

Source: Cash Salomon 3-Month T-bill, Barclays Capital Brothers U.S. Aggregate, S&P 500, Russell MidCap, Russell 2000, MSCI EAFE, MSCI Emerging
Note: The starting date of the MSCI Emerging Markets Free Index is December 31, 1988. Blend consists of 50% S&P 500 and 50% Int. Bond returns.

Test Your Risk Tolerance on Paper First

Historical Market Information

100% Stock

2008	-38.60%
2009	29.90%

80% Stock/20% Bonds

2008	-29.90%
2009	25.50%

65% Stock/35% Bonds

2008	-23.30%
2009	21.50%

Source: Cash Salomon 3-Month T-bill, Barclays Capital Brothers U.S. Aggregate, S&P 500, Russell MidCap, Russell 2000, MSCI EAFE, MSCI Emerging

Note: The starting date of the MSCI Emerging Markets Free Index is December 31, 1988. Blend consists of 50% S&P 500 and 50% Int. Bond returns.

Sample Asset Allocation Study

	Constraints		Efficient Frontier 3									
Asset Class	Min	Max	Port 1	Port 2	Port 3	Port 4	Port 5	Port 6	Port 7	Port 8	Port 9	Port 10
Large Cap US Equity	20	80	20	20	22	25	29	34	40	47	55	60
Small Cap US Equity	0	15	0	1	4	6	8	8	9	9	9	15
International Equity	0	15	0	1	3	4	5	6	7	7	6	0
Emerging Markets	0	5	0	2	3	3	4	4	4	4	4	5
REITs	0	10	0	1	2	2	3	3	4	4	4	0
Fixed Income	20	80	80	74	67	60	52	45	37	30	22	20

		Port 1	Port 2	Port 3	Port 4	Port 5	Port 6	Port 7	Port 8	Port 9	Port 10
	Expected Return	*6.10*	*6.32*	*6.54*	*6.77*	*6.99*	*7.21*	*7.43*	*7.66*	*7.88*	*8.10*
	Standard Deviation	*5.12*	*5.65*	*6.45*	*7.35*	*8.39*	*9.47*	*10.60*	*11.77*	*12.94*	*13.81*
95% of all return outcomes will be between +2 and -2 Standard Deviations	+2 Standard Deviations	*16.34*	*17.62*	*19.44*	*21.47*	*23.77*	*26.15*	*28.63*	*31.20*	*33.76*	*35.72*
	Expected Return	*6.10*	*6.32*	*6.54*	*6.77*	*6.99*	*7.21*	*7.43*	*7.66*	*7.88*	*8.10*
	-2 Standard Deviations	*-4.14*	*-4.98*	*-6.36*	*-7.93*	*-9.79*	*-11.73*	*-13.77*	*-15.88*	*-18.00*	*-19.52*

Asset Allocation Modeling for this presentation has been prepared through the use of Morningstar EnCorr software. The software features advanced asset allocation tools to create, analyze, and implement optimal portfolio strategies using historical data and modeling assumptions based on possible market conditions.

Diversified portfolios designed in an attempt to maximize returns at varying levels of risk have been built using the current investment guidelines of your portfolio.

Forecasting "test scenarios" are created based on a variety of simulated market conditions; results compare investment styles and performance over time. Risk-Return assumptions are based on Ferguson Wellman analysis. Performance estimates are an average annual percentage increase for all listed asset classes using historical market data. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown. Investing in the capital market involves risk and there is a potential for loss. Current and past performance may not be indicative of future results and other calculation methods may produce different results. Performance is shown gross of fees and do not reflect the deduction of investment advisory fees.

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What might the future hold?

What Might the Future Hold?

- Evolution of new products
- Products that provide stable streams of income to replace bonds with yield
  - Dividends, high yield
  - Looking at buying cash-flow streams (monetizing drug royalties, etc)
  - Leasing (real estate, aircraft, equipment)
  - Senior secured loans

What Might the Future Hold?

- Volatility: the Black Swan arrives with greater frequency

- "Environment requires nimbleness, non-traditional opportunities, complex investments with limited window, awareness of non-stationary correlations, risk management tools."

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Preparing Board Members

What Makes a Great Board Member?

- Invested in your College and your Foundation's missions

- Appropriate and available professional and/or personal skills

- People of affluence and influence

- Will make the time commitment to attend meetings – you cannot afford a board member who can't attend

Staff Commitment to the Board Members

- Provide clear job descriptions
- Provide a solid new board member orientation and yearly updates
- Provide clear and concise information
- Provide positive training opportunities
- Provide frequent and appropriate recognition

Role of the Investment Advisor to the Board and Staff

- Provide financial forecasting
- Clear, concise and timely reports
- Attendance at Finance/Board meetings when requested
- Open communication lines
- Guidance on investment policy

How to Select An Investment Manager That Fits Your Needs?

- Research, research, research
- Requests for proposals
- Check their track record against other firms in your area or throughout the nation

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Questions?