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## **Small Nonprofits Turn to Endowment Management Companies For Returns, Access**

By no means was **The Community Foundation Serving Richmond and Central Virginia** struggling when it came to investment returns over the past few years, returning 13.2% over a five-year period to beat its benchmark of 9.5% in the same time.

But that didn't mean that the community foundation, which was beginning to see the effects of a shaky economy late last year, wouldn't want to take the time to rethink its approach to only discussing strategies on a quarterly basis with its consultant, when the chance of good investment opportunities might have already passed them by.

And as the foundation grew and expanded its impact on the community, the needs of the people it served would always seem to exceed its investment returns.

"Our issues are manageable, the decline in gifts, the impact on revenues," said **Robert Thalhimer**, senior v.p. of advancement at the community foundation. "We can manage that by controlling expenses, but the greater challenge is meeting the increased demand for services in the community."

After much internal discussion and research into other possible options, the foundation decided to drop its consultant to pool its investments with the larger, separately-operated endowment investment management company associated with the **University of Richmond**, in what may be a precursor to numerous other nonprofits, desiring greater returns and access to better managers, deciding to transition funds to their large endowment counterparts.

Richmond's **Spider Management Company** has managed the fund's assets since February, Thalhimer said. He said that the decision to put its \$180 million in commingled investments with the management company's The Richmond Fund was the result of a due diligence review of its current investment structure that began three years ago. Now, instead of having 14 managers and the ability to only be involved in a handful of investment strategies, the fund and the others involved have exposure to over 100 managers as part of a nearly \$2 billion endowment.

Spider Management, an independent investment management arm of the university, oversees the institution's \$1.7 billion endowment and has more recently looked to partnering with Virginia-based nonprofits to pool their investments with its endowment and wealth of managers. Spider Management's returns were not available.

There appear to be at least five nonprofits that have taken the same route as the community foundation. **The Citadel Foundation**, which managed the \$164 million endowment of the Virginia military institute for a number of years, decided to make the switch to Spider Management in October 2007 in a move away from a more traditional 80% equity and 20% fixed-income portfolio previously managed by **Smith Barney**.

"By engaging in this transaction, we have diversified our holdings from six active investment managers in two asset classes to one hundred thirty-four active managers across six asset classes. The structure of the transaction leverages the size of The University of Richmond's endowment with ours, giving economies of scale that

allow The Citadel Foundation to invest in asset classes to which it would not ordinarily have access,” according to a statement on the fund’s Web site.

**Srinivas Pulavarti**, president of Spider Management, did not return phone calls and e-mails regarding the The Richmond Fund and its investors.

Thalhimer said there were various factors that went into the decision to drop its prior consultant-investment committee model to partner with the company, notably Spider Management’s dedicated investment staff and access to top-tier managers that the foundation would not be able to work with otherwise. More importantly, Thalhimer said, the company has produced returns consistently better than the community foundation’s portfolio had over recent years.

“We’ve developed a structure that enables this community foundation to get full diversification of all their investments...It’s a win-win situation,” he said.

The relationship serves to benefit the Spider Management as well. In addition to having full fiduciary discretion over all its underlying organizations’ investments, Spider is given a steady flow of cash and the liquidity that comes to the smaller funds throughout the year from donors.

As of late, having that liquidity has saved the company from having to take the path of a handful of its billion-dollar endowment peers. The investment companies that run the endowments of **Harvard University** and the **University of Virginia**, for example, have made public their desires to generate more liquidity by unwinding their private equity positions in the secondary market.

But what makes the situation between the community foundation and the investment management company both intriguing and complex is that it differs from any type of foundation-endowment relationship forged over the past 5-10 years, as far as Thalhimer can recall and history has dictated.

The main difference in those relationships to the one created by Spider Management is that the structure does not call for separately managed accounts—so the nonprofit gets the same diversification and manager structure that it has craved for years through the investment company as opposed to its own set of managers hired by Spider Management. That being said, it is still unseen at this point whether liquidity issues and losses by bigger endowments will make this structure all the more attractive in the coming years.

That is not to say there have not been similar partnerships created between universities and smaller nonprofits over the years. With the evolution of outsourced chief investment officer functions seen by the creation of the Virginia-based **Investure** and the well-established manager-of-manager structures used by **Commonfund**, **SEI** and **The Investment Fund for Foundations** (TIFF), endowments have now, more than ever before, a slew of options to gain greater access to a dedicated staff and investment managers.

At January’s NACUBO conference in New York City, consultants said they expected an overall growth in revenue and clients, while projecting that they will expand their external cio services according to a survey of institutional consultants.

The survey, conducted by **University of Saint Thomas** CIO **Michael Sullivan** and the research team at NACUBO, evaluated the responses of eight unidentified consultants categorized as “widely known.” The firms had a total of 942 foundation and endowment clients.

Overall, responding consultants expected major growth over the next five years, with four out of eight projecting a 10-15% growth in revenue and five out of eight believing that they will see a 10-15% growth in assets under management over the next five years.

In October, **North Carolina State University**’s board of trustees voted to hand about half of its \$545 million investment fund to the \$2.5 billion pooled funds managed by the University of North Carolina’s investment management company. **Jonathan King**, president of **UNC Management Co.**, has said that the company’s doors have always been open to the 17-member state university system since its inception in 2002. Of the 17 members, 11 institutions currently invest with the company.

The approximately \$3 billion **Duke Endowment** has outsourced its investments to the **Duke University Investment Management Company**. And on a much smaller scale, the \$95 million endowment of **Angelo State University** has outsourced all of its investments, mostly in the form of mutual funds, to the larger endowment managed by the **Texas Tech University System**.

After all is said and done, transparency becomes the larger issue for public nonprofits. Spider Management and other wholly-owned subsidiaries of universities are not bound by law to disclose investment information to the public, their common defense being concerns about losing relationships and sacrificing returns to their peers. But for some nonprofits, particularly community foundations, how they will be able to strike a balance between confidentiality and transparency to the donors that contribute to their asset base becomes the more significant question.

In the case of the community foundation, Thalhimer believes that, if anything, the foundation has gained transparency through its relationship with Spider Management based on the past three quarters since the relationship began. He cites the example of disclosure issues among hedge fund managers, where he would not know much about the underlying hedge fund managers in the fund-of-funds the foundation worked with.

"Previously we would invest in hedge fund-of-funds, and we had no real understanding of managers within those fund-of-funds," he said.

In this case, he said, the foundation gets a list of all the managers it is invested in (mainly through direct relationships), but is bound by a confidentiality agreement regarding their names. Once a year, the fund gets to know a bit more during its annual meeting, when the staff and donors have an opportunity they never did before—meeting a handful of its portfolio managers face-to-face.

"We only met three out of 100, but what we've actually found is that it's such a vibrant discussion of how Spider Management sees the world," he said. "We got to talk with managers and how they're doing, and then there's another level where we get to meet them. We've gained transparency if anything."