PART TWO OF FOUR

How are endowment assets overseen and invested?

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2016 SEI NONPROFIT SURVEY SERIES

Answers to Key Questions about Managing Nonprofits

Background

The SEI Nonprofit Management Research Panel completed a comprehensive survey of executives and investment committee members from nonprofits in the U.S. to gauge their views on a number of critical components of their organization. The poll was completed by 253 participants, representing nonprofits with endowments ranging in size from $25 million to more than $5 billion. None of the respondents are current clients of SEI. The poll was conducted in January/February 2016 and will be released in a series of chapters.

Summary

This chapter provides the results regarding different investment management models being used by nonprofit organizations, portfolio allocations and use of different asset classes and investment vehicles.

Nonprofit organizations continue to face challenges in an increasingly complex market environment, with several factors to consider when determining the appropriate asset allocation strategies and appropriate investment partners to help them with those decisions. These two factors are often critical to the overall financial success of the organization and play a crucial role in helping the organization achieve long-term goals and portfolio objectives.

The majority of the respondents to this survey were staff from the organization. They were asked about their asset allocation strategies and the role of discretionary delegation in their investment management model. The following three high-level conclusions were drawn:

1. Nonprofits continue to maintain an aggressive investment approach in search of long-term returns
2. Alternatives and global strategies are viewed as the preferred vehicles to increase diversification and to mitigate volatility
3. Nonprofit investment committees are increasingly relying on services of external providers

The following is a detailed outline of the statistics found in the second part of this research series on the conclusions mentioned above.

SECTION 1

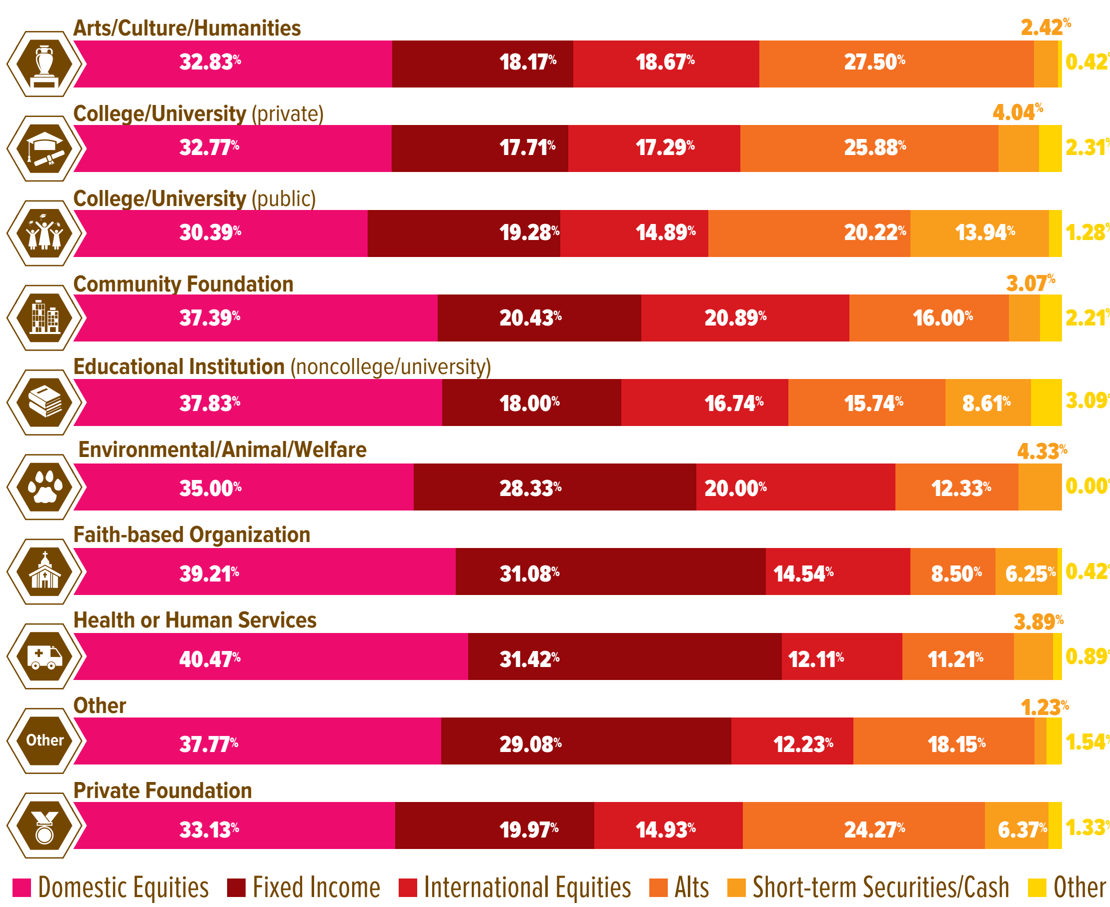
Nonprofits remain aggressive in seeking investment returns

According to nonprofits surveyed, on average, more than two-thirds **(68%)** of portfolios are invested in return-seeking strategies.

In an effort to exist in perpetuity, nonprofit boards and investment committees have always had a great emphasis on investment performance and overall returns. While the stewards of the assets don't necessarily have to answer to shareholders, their constituents are many, ranging from staff to donors to benefactors. Their challenge is to leverage donor and organizational assets to generate investment returns that can cover expenses, exceed inflation, meet the overall missions they serve and preserve as much of the overall corpus as possible. This is usually done with a disciplined approach focused on strategic asset allocation; however, many organizations appear to be pursuing returns somewhat aggressively. Of all of the nonprofits surveyed, the average allocation to nonfixed income or short-term securities was over 71%.

FIGURE 1

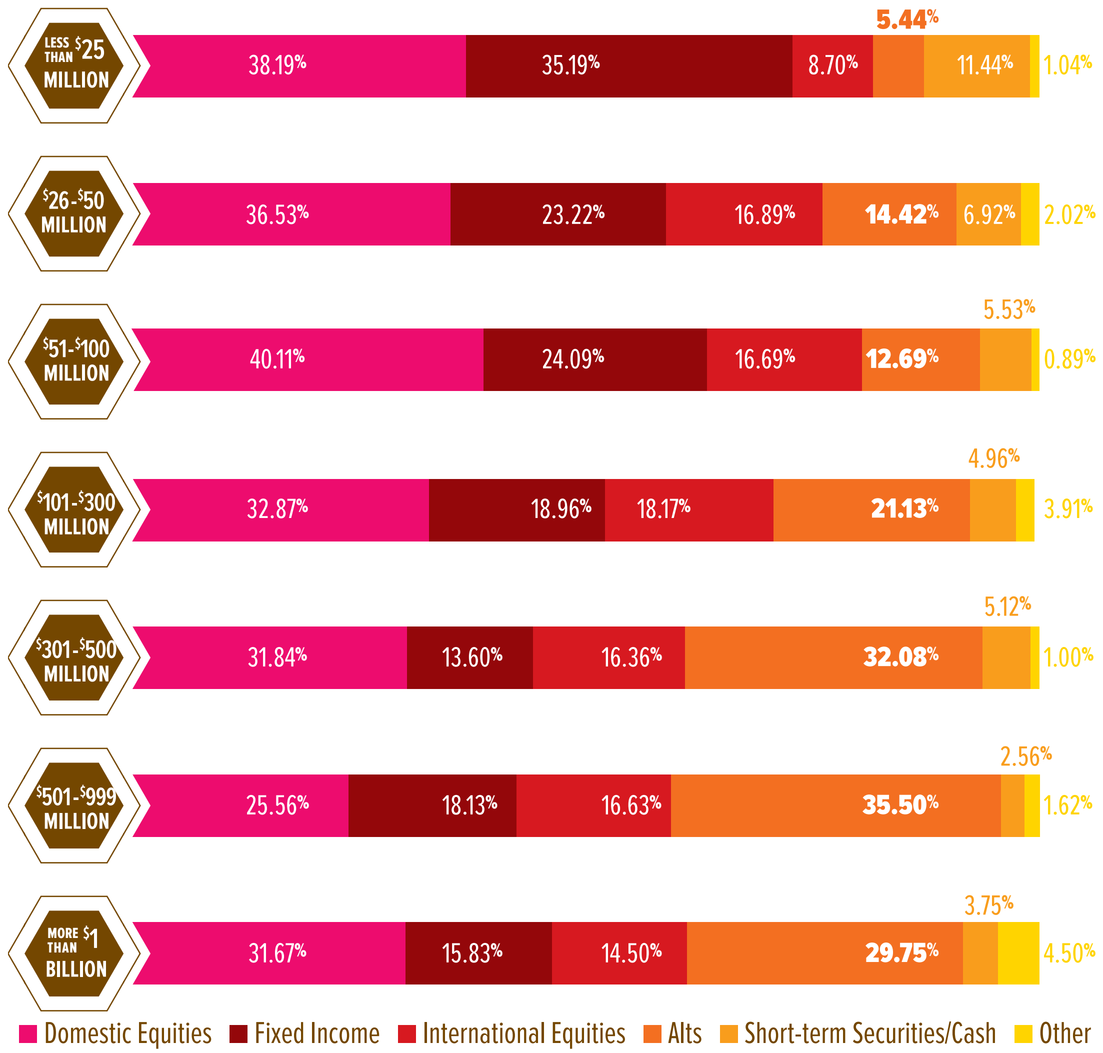
Mean asset allocation by type of nonprofit



Of course, the size of the overall investment pool will impact the organization's risk tolerance and overall ability to invest in nonliquid asset classes such as alternatives.

FIGURE 2

Mean asset allocation by size of asset pools of nonprofits



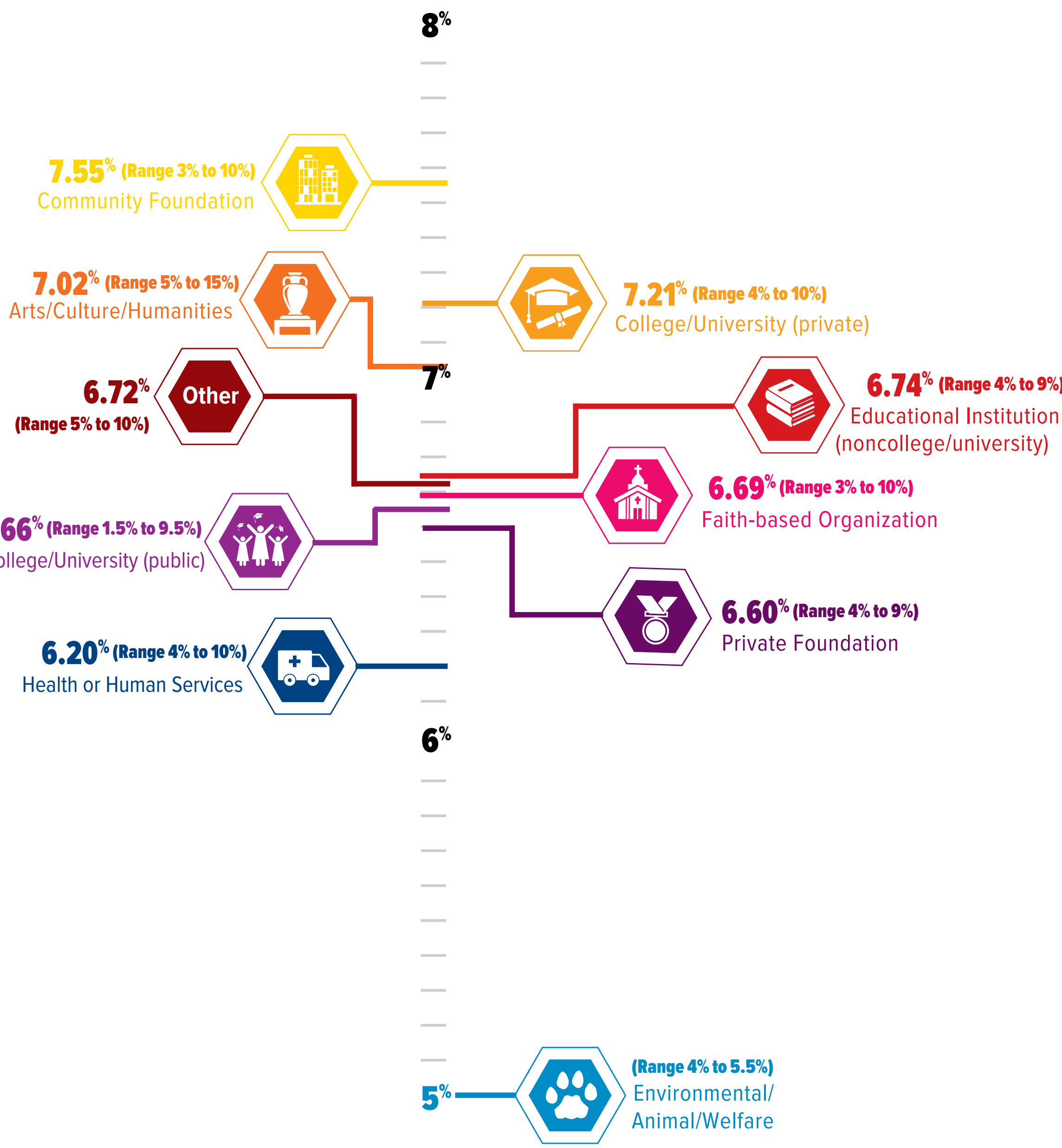
Return objectives for nonprofits surveyed ranged from as low as **5%** to as high as **7.6%**.

The asset allocations discussed above are designed to drive expected investment returns. As nonprofit organizations face extreme pressure to do more with less, investment returns and funding the organization's mission continues to be paramount to the organization's success. While equity market performance over the past three years should have provided gains for many nonprofits, return objectives have remained stable and reasonable. The overall average return objective for nonprofits participating in this survey was 6.9%.

Return objectives will vary based on the type of the organization and the way returns fund the overall mission. The nonprofits surveyed were asked if the return objectives included their investment management fees and more than three quarters (76%) said this was the case.

FIGURE 3

Nonprofits average investment return objectives based on type



DID YOU KNOW?

More than half (53%) of the community foundations surveyed had a return objective of 8% or higher.

SECTION 2

Alternatives and global strategies receive significant usage to increase diversification

80% of nonprofits surveyed believe that increasing diversification is the best way to mitigate volatility.

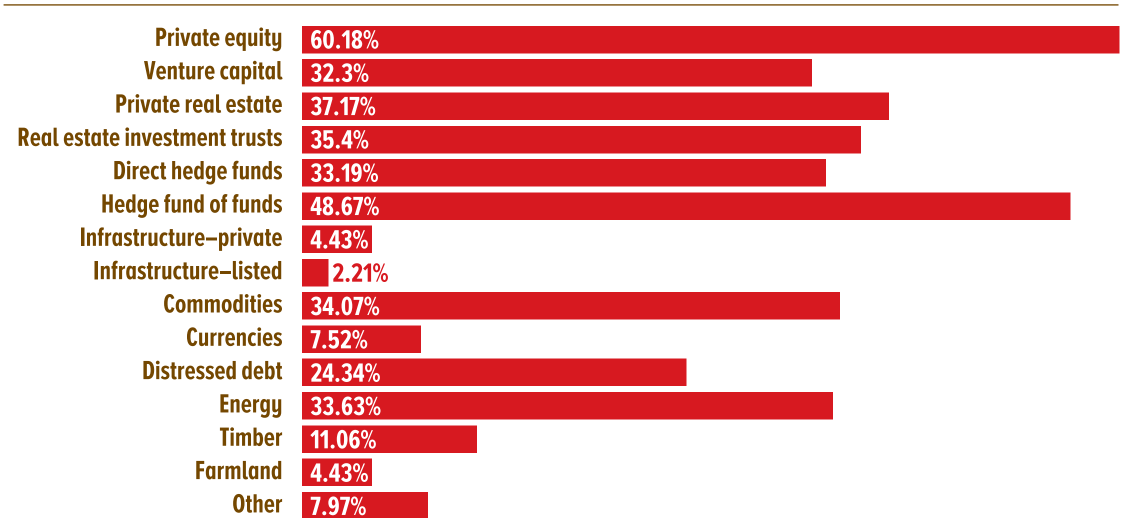
As important as return objectives are for nonprofits, the asset allocation of their portfolio is the road map for getting there. To mitigate volatility and boost potential for highest returns, organizations are focused on diversifying their portfolios while staying aligned with their overall mission. The poll results suggest that three areas are receiving significant attention: alternative products, global strategies and increased consideration of ESG/SRI strategies.

Almost all nonprofits have an allocation to alternative investments.

One of the lessons learned from the 2008 financial crisis was that conventional diversification strategies are not enough to mitigate market volatility. In an effort to increase returns and diversify portfolios, a vast majority of nonprofits surveyed (94%) have assets invested in alternative asset classes. Since the alternatives' origin of risk is less correlated with public markets, the intention of these investments is to provide returns more insulated from market fluctuations, while increasing potential for returns in an otherwise low return environment for traditional stocks and bonds. Of those with an allocation to alternatives, on average they invest a fifth (20%) of their portfolio in these products. There does not appear to be a near-term catalyst for reversing this trend, as a staggering 93% of respondents said they plan to either increase their allocation to alternatives or keep it the same in 2016.

FIGURE 4

Percentage of nonprofits investing in alternative products



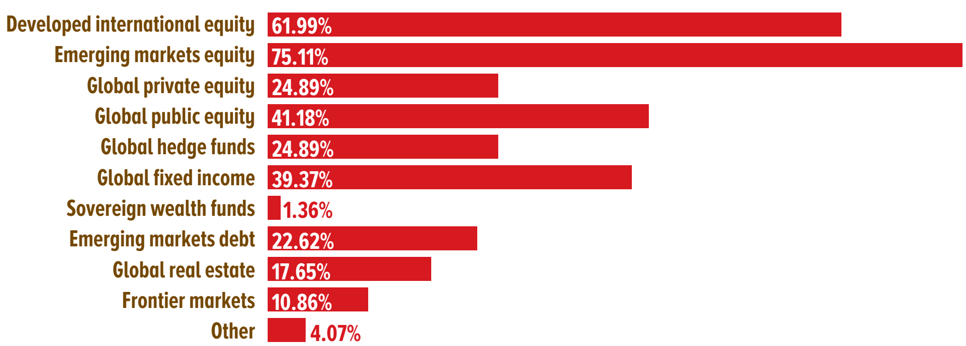
As the markets have rebounded significantly since the financial crisis and have continued to grow, it appears as though assets have returned to traditional growth vehicles, increasing their allocation to alternatives and equities.

Global investing is a major component of nonprofit portfolios.

The vote in Britain to exit the European Union (EU) is a recent reminder of how single economies can cause turbulence on global investing. Although the uncertainty in economies throughout the world has continued to make headlines over the past couple of years, the appetite for investing in non-U.S. securities has remained strong. Global asset classes provide yet another option for portfolio diversification and a vast majority (87%) of nonprofits surveyed have allocations to these products.

FIGURE 5

Percentage of nonprofits investing in global asset classes

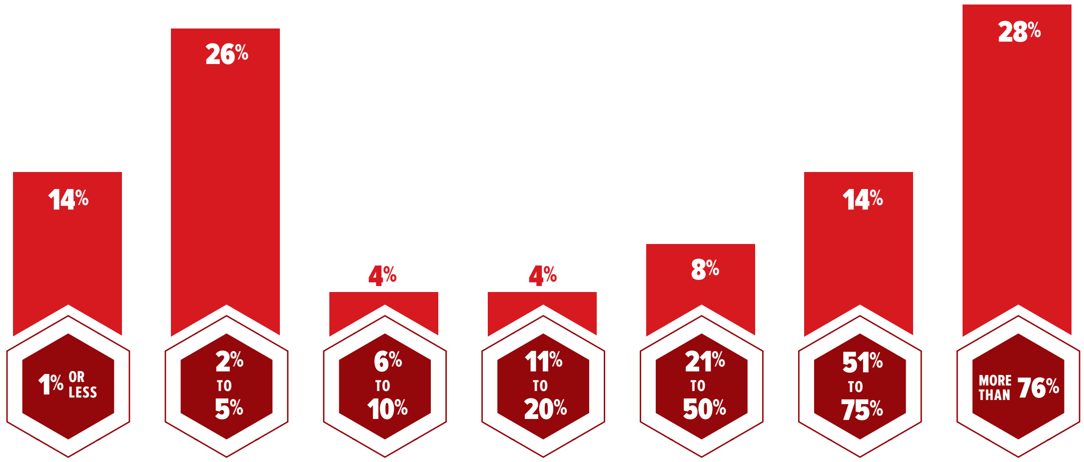


Despite a growing movement for Socially/Sustainable Responsible Investing (SRI) or Environmental, Social and Governance (ESG) strategies—which aim for organizations to generate long-term financial returns by investing in products that have a positive societal impact—nearly three-quarters (74%) of organizations surveyed don't invest in these products and don't plan to do so in 2016. This statistic is reinforcement that many organizations are uncertain of incorporating ESG criteria into a portfolio because it could potentially mean accepting a lower rate of return.

Of those that do invest in SRI/ESG products, almost a third (28%) have at least 76% or more of their portfolios invested in these strategies. It appears that, although there is not widespread use of these products yet, those that have adopted the strategies have done so wholeheartedly. With sustainability being a relatively new trend of the past decade, the idea to invest in products with a social benefit to society may continue to grow in coming years as more tangible results from a profitability/returns standpoint become available and as the markets continue to improve.

FIGURE 6

Percentage of nonprofits and amount of their portfolios invested in ESG*



*Percentage of total respondents may not sum to 100 due to rounding.

The most widely used asset class to implement SRI/ESG in portfolios is U.S. equity **(88%)**. Nonprofits named various asset classes that they currently use or plan to use to implement SRI/ESG in their portfolios.

- Almost half **(47.6%)** of nonprofits currently use or plan to use fixed income
- **44.6%** currently use or plan to use international equity
- **15%** currently use or plan to use real estate
- **10.7%** currently use or plan to use private equity
- Three listed options yielded percentages less then **10%** each; hedge funds **(9%)**, high yield **(4.6%)**, and other asset classes **(1.5%)**

Nonprofit organizations currently implement or plan to implement their SRI/ESG strategies in a variety of ways.

- Almost half **(49%)** listed using a negative screen to limit holding certain securities and include it as criteria in the investment policy statement (IPS)
- Close to a quarter **(24%)** listed using a positive screen to add/overweight securities with higher ESG rankings
- **21%** listed using impact investing to invest directly in companies/organizations that support their mission
- Only **14%** of nonprofits listed implementing ESG/SRI for a specific cause (i.e., global warming)

DID YOU KNOW?

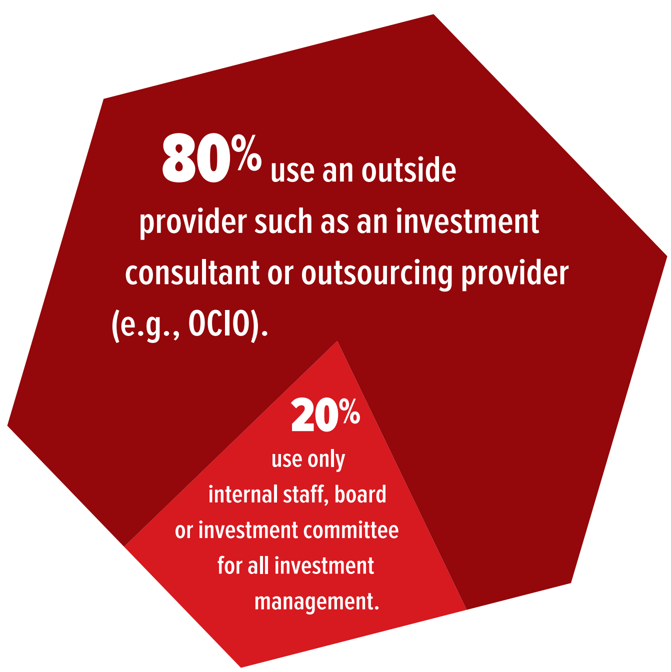
60% believe active management is the primary strategy for the long-term nature of nonprofit investments.

SECTION 3

Nonprofit investment committees are relying increasingly on services of external providers

More than a third (**36%**) of all nonprofits surveyed said the investment committee is concerned about the resources required to perform the necessary due diligence around investment managers.

Nonprofit trustees are quite challenged in their overall investment approach. For many, the time and resources needed to track the enormous array of investment products and managers is too much for investment committees that often meet only on a quarterly basis. Historically, nonprofits often depended on external support when it came to that aspect of investment management. The poll results supported this. More than three quarters of those surveyed, said they used an outside expert to support their investment management efforts.

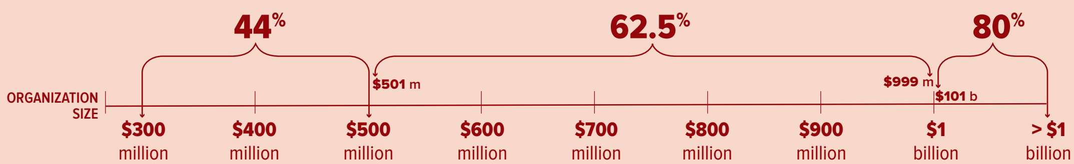


Internal resources are thin.

One of the main reasons nonprofits must rely on outside investment management support is that internal resources are somewhat lean. Of the nonprofit survey respondents, 10% don't have an investment committee at all. Three quarters (75%) of the nonprofits polled don't have a full-time chief investment officer (CIO) or someone solely responsible for overseeing investments on staff. From a committee perspective, over a third (34%) have two or fewer members with professional investment management experience.

DID YOU KNOW?

The percent of organizations that have a full-time CIO or someone else solely responsible for overseeing investments, goes up as the size of the organization increases.



External resources provide value for nonprofits.

The nonprofit organizations surveyed were asked where their external resources provided the most value and the results varied depending on the type of provider being used.

For those currently using an investment consultant:

- The highest percentage **(79%)** of that group said the value provided was in committee education.
- Three quarters **(75%)** identified rebalancing the portfolio's asset allocation as the most value provided.
- Half **(50%)** said the value was in money manager hiring/firing.

For those currently using an outsourced chief investment officer (OCIO):

- The highest percentage **(97%)** of that group said the provided value was asset allocation changes within ranges established in the IPS.
- More than three-quarters **(77%)** said value provided was in money manager hiring/firing.

As previously mentioned, more than a third (36%) of all nonprofits surveyed said the investment committee is concerned about the resources required to perform the necessary due diligence around investment managers. Of the investment committees concerned about the resources required to perform the necessary due diligence around investment managers:

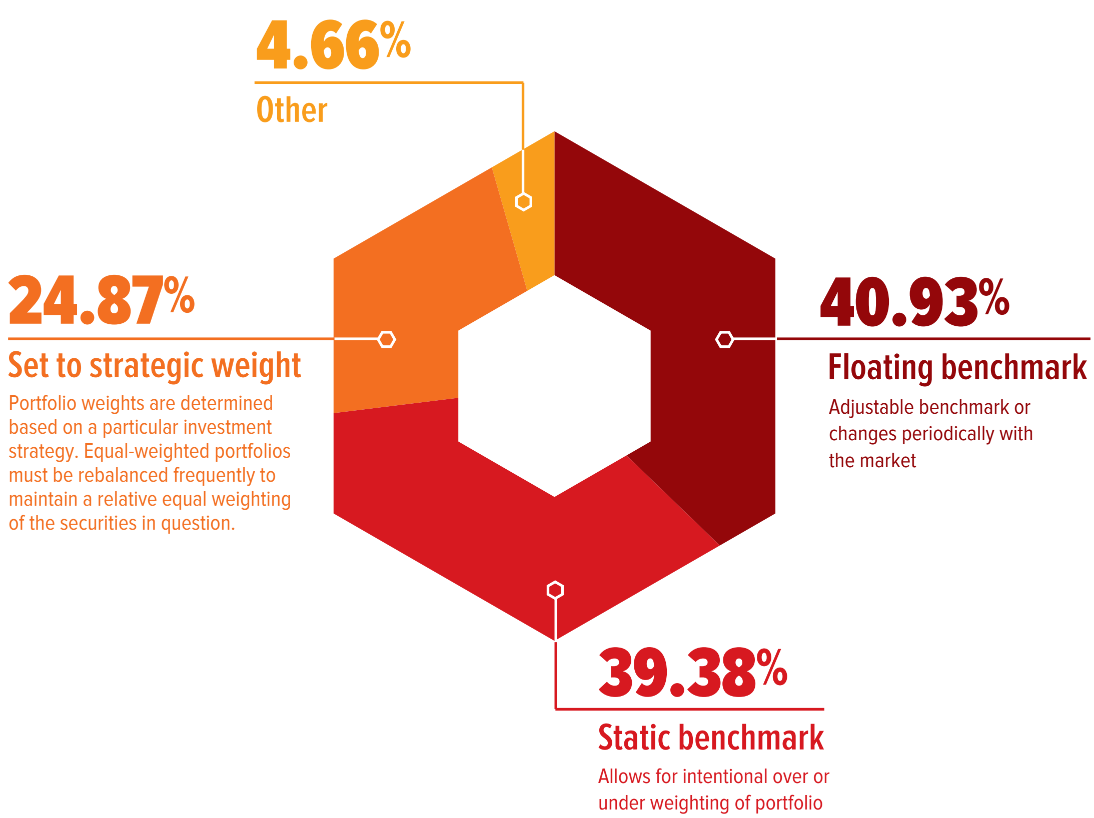
- **67%** use an investment consultant
- **20%** have no outside support and handle it internally
- **13%** use an OCIO

How to measure discretionary providers and asset allocation decisions?

Overall, nearly three-quarters (73%) of those surveyed said their external resource provides value when it comes to asset allocation changes within ranges established in the IPS. As a greater amount of nonprofits are delegating discretion over asset allocation to their external investment providers, measuring effectiveness of those decisions can vary. When outside providers assume decision-making authority for asset allocation, how do nonprofits determine the value that discretion provides?

FIGURE 7

How poll respondents measure the value of delegating discretion over asset allocation changes



Conclusion

This chapter of the survey results sheds some light on different asset allocation approaches that nonprofits are using to help meet return objectives and the investment management providers they chose to help them reach their goals. Diversification has become a key component in boosting returns and minimizing risk, and investing in alternatives, global strategies and SRI/ESG strategies are the main avenues for doing this. However, it appears that some of the investment management models these organizations have chosen may not be providing value where they could be. For those not using an investment partner and relying on their investment committees, the committees are generally small in size and would appear to benefit from additional resources and expertise.

If you want an advance copy of future releases in this series, visit us online at **seic.com/nonprofit2016** or email **seiresearch@seic.com.**

2016 SEI Nonprofit Survey Series

Answers to Key Questions about Managing Nonprofits

Part 1: Are boards and investment committees supporting their nonprofits most efficiently?

Part 2: How are endowment assets overseen and invested?

Part 3: Are fundraising efforts supported and as efficient as possible?

Part 4: How are spending policies developed and implemented?

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