

UW SYSTEM TRUST FUNDS EVALUATION OF ENDOWMENT ACCOUNTS AS OF JUNE 30, 2018

Background

Following Wisconsin's enactment of the Uniform Prudent Management of Institutional Funds Act (UPMIFA), which became effective August 4, 2009, the Business and Finance Committee approved the use of these internal practices at their meeting of October 16, 2009:

- Continue to use HDV as that amount reported in financial statements as “restricted – nonexpendable” or “permanently restricted” for donor-designated endowments.
- Continue to review at least annually, the market value of endowments compared to their HDV, *as well as their CPI or HEPI-inflated HDVs*, and generally operate to restrict spending where the maintenance of purchasing power into perpetuity is deemed to be in jeopardy. However, allow benefiting units to appeal any decisions to curtail appropriation based on extenuating facts and circumstances.

“HDV” refers to the concept of “historic dollar value,” which was an integral part of the prior law, UMIFA. HDV represents the fair value of the endowed gift when it was first received. Also, the term “underwater endowment” is used to refer to an endowment fund whose market value is less than the fund's HDV. Finally, it should be noted that UPMIFA's reference to an “endowment” is a reference only to a fund the donor has designated as such. However, in the recent past, the Board has chosen to treat Board/institution-designated endowments no differently than donor-designated endowments.

Results of Current and Past Evaluations

An evaluation by individual endowment account, of which there are hundreds, has not been performed since the June 30, 2016 fiscal year-end, at which time no suspensions of distributions were implemented. Since June 30, 2016, the magnitude and pattern of positive investment returns indicate that there have generally only been improvements in accounts' market values versus their historic dollar values. The results of the evaluations for the past three fiscal years, including the most recent fiscal year (2017-2018), are provided below.

The report as of the fiscal year-end June 30, 2016 concluded the following:

[T]here were five true endowment funds that were underwater versus their actual HDVs, one at almost 7% under and the other four at less than 5% under. There were 37 true endowment funds that were underwater versus their CPI-inflated HDVs: five of these funds were underwater by approximately 10%, 13 between 5% and 10% under, and the other 19 funds were underwater by less than 5%.

With regard to designated endowments, there were three funds underwater versus their actual HDVs, ranging between approximately 1.5% and 6.2% under. There were 37 designated endowments that were underwater versus their CPI-inflated HDVs: five of these funds were underwater by between 10% and 13%, 16 between 5% and 10% under, and the other 16 funds were underwater by less than 5%.

Endowment funds underwater the most were those having inception dates clustered just before the “tech

stock bubble” that burst in 2000, and just before the financial crisis meltdown of 2008. Note that endowment gifts are generally invested when received, at the next following quarter-end.

Actions for Fiscal Year 2017

As there are currently no endowment funds underwater versus their HDVs by more than 10%, and only ten funds underwater versus their CPI-inflated HDVs by between 10% and 13%, *no distributions will be suspended on any endowments for fiscal year 2017.*

The report as of the fiscal year-end June 30, 2017 concluded the following:

Due to strong investment returns experienced by the Long Term Fund for the full fiscal year ended June 30, 2017, there has only been an improvement in the number of underwater endowment accounts since the end of the prior fiscal year-end and the degree to which they were underwater. The 2017 fiscal year investment return was +12.7%. For endowment accounts which received spending distributions for the full fiscal year, their market values grew by approximately +8.2% (the investment return less fees/expenses and less the 4% distributed). Furthermore, due to the level and pattern of quarterly returns experienced during the fiscal year (+4.6%, +0.6%, +4.7%, and +2.3%), no new endowments established *during* the fiscal year found themselves underwater as of June 30, 2017. (Note: New endowment accounts are invested as of the next quarter-end following their establishment.)

Actions for Fiscal Year 2018

The market values of all endowment accounts versus their historic dollar values continued to improve during fiscal year 2017. Therefore, *no actions (i.e., suspension of spending distributions) will be taken as of the September 30, 2017 quarter-end.*

Conclusions as of the most recent fiscal year-end, June 30, 2018:

The investment return for the Long Term Fund for the full fiscal year ended June 30, 2018 was +8.1%. For endowment accounts which received spending distributions for the full fiscal year, their market values grew by approximately +3.0% (the investment return less fees/expenses and less the 4% distributed). Furthermore, due to the level and pattern of quarterly returns experienced during the fiscal year (+3.2%, +3.5%, +0.6%, and +0.6%), no new endowments established *during* the fiscal year would have found themselves meaningfully underwater (e.g., more than 2%) as of June 30, 2018. (For example, an endowment newly invested as of December 30, 2017, would have experienced a net decline in the market value of its corpus of approximately -1.2% as of June 30, 2018.)

Actions for Fiscal Year 2019

The market values of endowment accounts held as of the beginning of fiscal year 2018 continued to improve/increase versus their historic dollar values during fiscal year 2018. For endowment accounts newly invested *during* fiscal year 2018, none would have declined relative to their actual historic dollar values by more than 3%. Therefore, *no actions (i.e., suspension of spending distributions) will be taken as of the September 30, 2018 quarter-end.*