Fiducient Advisors, Nonprofit Investment Stewards Podcast
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Peer Benchmarking Using the 2021 NACUBO-TIAA Study of Endowments with Devon Francis

[00:00:00] Welcome to Nonprofit Investment Stewards with Bob DiMeo and Devon Francis from Fiducient Advisors. Bob and Devon are passionate about helping nonprofit organizations prosper. Whether you oversee endowment, foundation, or retirement plan investments, this podcast exists to help stewards improve performance, reduce costs, and discover strategies that enable your charitable organization to prosper and advance its mission.

Now onto the show. Hello, and welcome back to the Nonprofit Investment Stewards podcast. I'm Bob DiMeo, as always, joined by cohost Devon Francis. Today, I'll be wearing the interview hat while Devon is the interviewee. We'll be talking about a resource that we at Fiducient and many of our college and university clients use.

It's the NACUBO-TIAA Study of Endowments. This study is released each year in late February, and it provides an opportunity for colleges and universities to compare themselves to their [00:01:00] peers in a lot of ways. We also use the study as a peer benchmarking tool for our clients. So, without further delay, let's dig into this important resource.

So, Devon, NACUBO, or the National Association of College and University Business Officers, combined with TIAA, issues this on an annual basis. Tell our listeners about the study, who responds to it, how many respondents, that sort of thing. Sure. Yeah, it's a very robust study. There are about 720 respondents, at least this year.

And that's pretty consistent with what we've seen historically. The respondents represent colleges and universities, both public and private, and also some institutionally related foundations. Broadly speaking, this year, the respondent's represented over 820 billion in assets. And the study results are divided into seven cohorts or peer groups from endowments under 25 [00:02:00] million to over a billion, and results are based on the fiscal year end.

So, when we talk about results, we'll be talking about data points as of 6/30/2021. So, looking back about eight months or so. And then who is the information intended for? Yeah. As you mentioned, Bob, I think that it is largely used for colleges and universities to see how they stack up relative to peers.

It's always good to kind of get your, your finger on the pulse of what other institutions are doing. And I think endowments, university and college endowments, really place a lot of emphasis on what peers are doing and think that that's something important to be aware of. And we certainly agree.

I think it's also used by practitioners such as ourselves, other investment consultants in the field, looking at the landscape, identifying trends. We use it to see how our clients look relative [00:03:00] to other institutions, how their performance has been, what their asset allocation profile looks like. So, I think it's useful in really many different ways.

Yeah, that's terrific. It's funny. Just yesterday, I was on with a client, this is a university based out east, and they have a new chief operating officer. And the chair of the investment committee asked us to just meet with her, bring her up to speed on the investment strategy that's in place, and that sort of thing.

And we found ourselves several times referencing the study and how they are really set up, whether it's spending policy or other areas, relative to let's say their peers. So maybe you can share a bit about the type of information that's presented in this study. Yeah, there is a lot in there. So, this year, it starts off with broad market commentary in the investment environment.

And obviously, COVID has had a really significant impact on that. So, that's the introductory chapter. And then it follows up with endowment [00:04:00] values and gifts, talks about spending policy, a big section on investment returns, which probably is the most intriguing part of this study for a lot of folks that use it, asset allocation, debt, responsible investing, and then it finishes up with portfolio management practices.

So, there's a lot of information throughout the study. And Devon, are there any caveats or things that folks reviewing the metrics and such should be aware of? Yes. We always advise our clients to take everything with a grain of salt for a few different reasons. One is that the results that are shown throughout the study are dollar weighted.

So, what that means is that the largest institutions have the most significant impact on the results that are shown. So, as I mentioned, there are seven underlying cohorts or peer groups ranging from endowments over a billion to institutions with endowments less than 25 million. [00:05:00] Well, because the results are dollar weighted.

The results are skewed very heavily towards the larger institutions, which may not always be a relevant point of comparison for smaller institutions. So, that's the first thing. The second thing is that these results are self-reported. So, of course, it would be a vast undertaking for NACUBO or TIAA to you know, fact check or confirm all of the numbers that are reported from these 720 responding institutions.

But the fact that everything is self-reported means that there could be errors. And there is no fact checking that's done. And then the third takeaway is that, uh, we try to remind folks that it's not necessarily important to look like your peers. So, I think it is a, you know, it's a helpful barometer and a yardstick against which you can measure your performance and look at your asset allocation profile.

But, you know, you may have an institution with a much higher [00:06:00] spending policy than what's typical and their allocation profile will need to be different because of that. You may have a university that's essentially a fundraising machine and they've got contributions coming into the endowment hand over fist.

And there are no liquidity concerns, so they can have a much higher allocation to private markets. So, you know, I think it's important to keep things in perspective and what's right for your institution may not be right for other institutions. So, you don't need to look exactly like your peers. Those are great points.

You're making me think that it's really an important component or tool in the overall mix. I know we have clients that will look at NACUBO and let's say, how do I line up or how do we line up against the 100-200 $50 million institutions and that cohort, but we'll also have universities say, hey, these are our six true peers.

And we'd like to do whatever sorts of comparisons on numerous fronts that might be available there. So that's helpful. [00:07:00] So we talked a little bit about the limitations. Let's talk to what I think you inferred as sort of the main feature most years, and that would be investment returns. So, what can you say about the investment returns?

What they looked like in 2021? And I think you're saying it would be that's the period ended June 30th, 2021. That's correct. So, in this study, the average one-year return for the fiscal year 2021, as you said, ended June 30th was 30.6%. Not bad. Exactly, I think we'd take that every year we could. So, you know, it really was a banner year for most institutions. Compare that to fiscal year 20 when the average return was about 2%.

So, we're going through 2% to over 30%, which was really remarkable. And, uh, particularly as we record this towards the end of the first quarter of 2022 where the markets have not been very kind, you [00:08:00] know, it's kind of interesting to look back and see those very robust returns. So, what's, what's also interesting is that that very strong fiscal year 21 return brought up the longer-term results as well.

So, the three-year annualized return is now coming in at about 12%. The five-year annualized return is coming in at about 11%, and the 10-year annualized return is coming in at 8.5%. So those are some really robust numbers. And for most institutions, those numbers are more than sufficient to help them meet their return objectives.

Absolutely. And you sort of inferred the reasons behind the dispersion between 2021 versus 2020. But do you want to chat a little bit more about? Yeah, sure. So, of course, the market environment was remarkably different between fiscal [00:09:00] year 2020 and 2021. Fiscal year 2020 was ending just as we were, you know, beginning to emerge from the economic hit that the, the pandemic brought on.

So, certainly, it was a much more favorable market environment in 2021, but what's interesting is that there was distinct dispersion in returns this year between the different size cohorts, which was not really the case last year. So, in the, in the 20 study, there was not much dispersion between the largest and the smallest peer groups, but this year, there was a fair amount of dispersion between the, the largest peers and the smallest.

So, for example, the institutions with an endowment over a billion returned about 37% in fiscal year 21, whereas institutions in endowment under 25 million, uh, returned about 24%. So, 37% for the largest peer group, [00:10:00] only 24 for the smallest peer group. And I really think that that dispersion is attributed to asset allocation.

So, the largest endowments tend to have a very high allocation to private markets, particularly venture. And as we all know, venture and private markets performed remarkably well over the past year. So, it's that allocation to the private markets that really kind of catapulted those very large institutions ahead of the smaller institutions.

And also, smallest institutions tend to have a higher allocation to fixed income. So, when you have an equity market that's really robust and you're talking about perhaps a 30% allocation to fixed income, you're not going to be able to keep up with those institutions that have, you know, a more aggressive allocation profile.

So, I really think that was the genesis behind the return dispersion that we saw this year. What's also interesting is that the study measures dispersion [00:11:00] within the peer groups. So, it showed the amount of dispersion, for example, within the over a billion peer group, within the under 25 million peer group.

And the dispersion within the larger peer groups was more significant than within the smaller peer groups. And again, that's related to the exposure to private markets. We've talked about how in the private markets choosing the right managers really makes a big difference. There's a lot of dispersion among returns within private markets, and there's less dispersion among the public markets.

So that's why the results for the smaller peer groups did not range as widely as results for larger periods. That's so insightful, Devon, and it makes me think about the importance of really setting a strategy in a very thoughtful manner for a particular institution. Right? It can be very easy to get caught.

Let's say you're on an investment committee of a $75 million [00:12:00] endowment. It's easy to get caught up in what's going on over there. But, you are what you are and you have maybe certain limitations or even certain prudent strategies that make sense for the size institution you are. And to really have an understanding of that is incredibly important.

So, thanks for sharing that. And you've talked a little bit about asset allocation. What else would you like to share on the asset allocation front that's presented in this study? Yeah. One of the most important things I think is, within the asset allocation results, this is where I feel like due to the dollar weighted reporting mechanism, it's more helpful to look at the individual peer groups rather than the results reported for all institutions.

So, you know, as I've already mentioned, endowments over a billion have a lot more exposure to private markets. About 30% of their portfolio is in private markets. About half of that is within venture capital.

And by contrast, endowments under 25 million tend to have [00:13:00] less than 1% in private markets. So that's a, that's a big difference. And when you dollar-weight the results, the results are kind of erroneously skewed to indicate that there's a larger allocation to alternatives and privates and that sort of thing really across the marketplace.

So, I think it's important to look at each individual peer group. And for example, if you are a college or university and you are looking at your own profile relative to peers, I think it's important to just focus on your peer group or perhaps the surrounding, so maybe plus or minus one deviation.

But so, generally speaking, smaller endowments tend to have a much higher allocation to fixed income. The smallest peer group has a 30% allocation to fixed. The next smallest has a 25% allocation to fixed. In contrast, the endowments over a billion have only about a 10% [00:14:00] allocation to fixed income and that exposure is much more diversified.

Whereas within the smaller institutions, you're really just looking at investment grade bonds by and large. In terms of public equity exposure, for the largest institutions, they have only about 20% of their portfolio allocated to the public markets. And it tends to skew a little more heavily towards international.

So, the international public equity allocation is a little bit heavier than the domestic equity allocation. And of course, within the two smallest cohorts, you're looking at a much larger allocation to public markets, a more distinct home country bias. So, there are really a lot of differences between allocation profiles when you go kind of up the size, um, spectrum.

That's helpful, Devon. And maybe we shift gears now. I had mentioned I was just speaking with a client and we're [00:15:00] talking about spending policy. This is a university chief operating officer, and she's working with her board and committee and such. And tell us what the study reveals about what colleges and universities are doing on the spending trends.

Yeah, they definitely had some interesting data points about spending. The average effective annual spending rate in fiscal year 21 was 4.54%, which was very consistent with last year's results. So not a big difference in terms of the percentage that's being spent. One interesting little nugget was that, um, spending for private colleges and universities tended to be a bit higher than for public universities.

So, we were looking at about four and three quarters rather than four and a quarter or so. Um, so that was an interesting divergence and, um, the smallest institutions tended to spend the least, so they were right at about 4%, whereas the largest cohorts tended to be just north of [00:16:00] that four and a half percent range.

One of the things that's interesting about this study is they ask respondents whether they plan to change their spending practices in the future. By and large, most institutions plan to stay about the same. Um, so more than 80% intended to maintain their current spending policy with about six and a half percent intending to increase their spending and about 11 planning to decrease their spending.

So, it seems like most institutions either are comfortable with where they are in terms of their spending policy, or they simply need to, um, they need to maintain it in order to be consistent and give the institution what it needs.

One thing that I did find quite interesting and really as a result of the COVID environment, is that more than half of the responding institutions increased support for their institutions' operating budget [00:17:00] in fiscal year 21. So even though the spending policy and the spending rate did not change, more of those endowment dollars went towards operating support than had in year past, in years past.

And that was really a result of institutions still struggling from the pandemic, loss in tuition, loss of room and board, and needing those endowment dollars to support the operating budget. In terms of spending rules, about three quarters of respondents use a percentage of a moving average rule.

So that's consistent with what we've seen in years past that is by a wide margin, that's the most popular type of spending policy. And then, about 10% use a hybrid method, which involves some sort of a combination of an inflation calculation alongside a moving average calculation. And then the remainder use other [00:18:00] rules like spending all current income or deciding on the appropriate spend rate each year and that sort of thing.

But by and large, we're really looking at a percentage of a moving average rule being the most common rule. And when we talk about spending, you're making me think about the episode. I think it was episode 14 where I also interviewed you and you really gave great insights on the spending front. So, I would suggest folks check that out as well.

Uh, let's talk about another really important topic in the college university space and frankly in nonprofit organizations overall, and that would be ESG. What does the study have to say about ESG or socially responsible investing? Yeah, it was a big focus of the study. The results showed that there has been increased adoption of responsible investing practices, perhaps not as much as you might expect.

But let's say within the U.S. equity portfolio, [00:19:00] that's where you see the most significant adoption of responsible investing practices. And that was 28% in fiscal year 21. So, 28% of responding institutions incorporate responsible investing into their U.S. equity portfolios. And that's in contrast to last year when that number was about 20%.

So, you see an eight-percentage point increase. It's quite substantial. And there were increases in the use of responsible investing across every asset class. One thing that I thought was an important takeaway is that over 70% of endowments over a billion dollars, so again, we're talking about the largest cohort, say that responsible investing plays a role in their manager due diligence process.

So that's something that we are seeing more frequently throughout the industry is kind of ESG integration. So active managers using ESG criteria as a component of [00:20:00] their investment process and their investment philosophy. Not everything hinges on, you know, a certain ESG rating. But it is incorporated into the process. And the study results were consistent with that.

Oh, a kind of a shocking data point from my perspective was that over 80% of respondents reported that they have incorporated ESG language into their investment policy. Over 80%. But this is where it, uh, it's really obvious or it illustrates that you need to dig a little bit deeper with some of these data points because that number just jumped out of the page at me.

Oh my gosh, 80% have ESG language incorporated into their IPS. So, I looked a little bit deeper, and remember that I mentioned there were 720 survey respondents? Only 210 answered the questions about responsible investing practices. So, you're talking about a much smaller [00:21:00] sample size. And if you think about the types of institutions that would be inclined to answer those questions, it's probably the institutions that are making progress with regard to responsible investing.

So, you know, it's kind of a self-selected sample. And, um, the, the most striking data point that I saw within that section was that a hundred percent of institutions below 25 million indicated that they incorporated ESG language in their IPS, a hundred percent. So again, I peel back the layers of the onion, in the broad survey, there were 29 institutions that fell within that peer group.

Only three of them answered that question. So, okay, of, you know, twenty-five million dollar or less, three institutions incorporate ESG language into their IPS, but you know, so that's where I think it's important, um, it's interesting to see the trends. I know that that responsible investing and [00:22:00] ESG and mission aligned investing, you know, all those topics are, are certainly gaining a lot of focus and attention.

And I think that they're being discussed at investment committee meetings broadly. But there, uh, I still think that we do have a way to go in terms of adoption. Devon, I love your investigative work here. It's outstanding because you could just see someone on the administration or a board member sort of waving this statistic around.

And boy, if you don't unpeel the onion, you're walking away with a different impression than reality. Yep. Absolutely. Yeah. So, tell us about any other trends that were discussed or revealed in the study that listeners might want to be aware of. Yeah, like I said, there is a lot of information to unpack within this study. A few interesting tidbits or takeaways.

One was the adoption of OCIO, outsourced chief investment officer, that type of a model rather than a [00:23:00] traditional consulting model. So, there was an increase in endowments using an OCIO model. That's now at 43% compared to 41% last year. So not a hugely significant increase, but compared to 10 years ago where the OCIO model only represented about 34% of endowments, there certainly has been a trend towards outsourcing.

So, that was an interesting takeaway. And then a lot of focus on diversity, equity, and inclusion, as well as climate change. So, particularly with regard to the responsible investing practices, a lot of institutions reported that DEI and/or climate change were kind of the genesis behind an interest in adopting more responsible investing practices.

So that certainly was an area of focus within the study. And I think is increasingly an area of focus [00:24:00] for you know, at most investment committee meetings. Those topics also aligned very nicely with prior episodes. So, I'll just mention, we do have an episode on OCIO and other one on diversity, equity and inclusion and climate change is captured in one of our ESG mini miniseries.

So, for listeners who haven't checked those out, we'd encourage you to do that. And, and Devon, you've shared so much that's really helpful and insightful in terms of the NACUBO-TIAA study. There's also a separate study for independent schools. Do you want to comment on that? Yeah, absolutely. That study is called the Commonfund Benchmark Study of Independent Schools.

And that is also a collaboration between Commonfund and NBOA, which is the National Business Officers Association. Very similar data reported. So, you're looking at returns, asset allocation, spending policy, that sort of thing. This is a smaller study. So, there are 215 respondents compared to 720 for the endowment [00:25:00] study.

And the results are broken into three cohorts. So, you're looking at endowments under 10 million, between 10 and 50 million, and then over 50 million. So, if you think about that in contrast to the endowment study, with the endowment study, you're looking at by and large much larger asset pools. So, the average return reported for fiscal year 21 for the independent school study was 25.8.

So, remember it was 30.6 for the endowment study. So, you're looking at about five percentage points less. But of course, that makes sense because we're dealing with smaller asset pools, typically less exposure to private markets, less exposure broadly to alternative. We saw very similar trends within the independent school study.

A lot of conversations around responsible investing, similar spending trends, the average spend rate for independent schools was [00:26:00] 4.3%. So very similar trends. But I do think that that independent school study, it can be an important tool for, for folks in, in the secondary ed space. Yeah, and definitely, we have a number of clients in that space and they access that just like the universities access the NACUBO study.

So, this is absolutely wonderful. Devon, you shared terrific insights, so appreciative. Anything else? Yeah. Bob, let me ask you one question. I'll turn the tables. So, you know, as we've talked about the NACUBO study, it's used by many colleges and universities and it can be helpful for other types of nonprofit organizations.

But in many cases, it's not completely irrelevant. Do you want to touch on the project that we hope to be resuming this year? Absolutely. I'm glad you raised it. We actually have a large Arboretum client and we have many zoos and arboretums gardens and such. And so, they will use the NACUBO study because, hey, these are other non-profits and they might be similar in [00:27:00] size and it's sort of the best available comparisons in data, but it really is, um, not overly relevant in many instances, right?

You think of a zoo or an Arboretum and think of sort of their structure and model relative to a university. And it just doesn't align on many fronts. So, uh, this, uh, large client in Arboretum introduced us to the American Alliance of Museums. And we actually worked with Laura Lott, who has been on one of our recent episodes here talking about the museum space and such.

And we began a study, as you know, Devon, of museums. And this was in, I believe it was February of 2020, and basically including the same sorts of benchmarks and such, many of the benchmarks you'd see in the NACUBO study.

Well, then of course, the pandemic raged and, uh, think about just, uh, the administration, financial officers and such at museums and the like were spending their time. So, we [00:28:00] shelved that, but we hope to resume that later this year and think that will be a really useful resource for museums and, and similar institutions just with slightly more spot on comparisons.

Yeah, absolutely. I know that many of my nonprofit clients ask for peer benchmarking and it can be hard to find relevant results that correspond to, to what they're doing or what their goals and objectives are. So that's great. Yeah. Yep. So hopefully, uh, we, we are able to kick that off later this year.

Well, Devon, thank you. It's, it's fun to do this format. Thank you so much for being such a terrific guest and a terrific cohost. I really appreciate it. Yeah, of course, happy to do it. Wonderful. Well, as we already stated the study of endowments, it's a joint effort by NACUBO and TIAA. If you'd like more information or want to obtain a copy of the study, go to nacubo.org.

We'll have all this in the show notes. And the study of independent schools is conducted by [00:29:00] Commonfund and NBOA, and you can go to commonfund.org to request a copy of that study. Fiducient is in the habit of conducting an annual peer benchmarking exercise for our college and university clients, as well as our independent school clients.

And if you have any interest in having us conduct a review for you, please reach out. Devon and my email and information is available in the show notes, and you can always reach us on LinkedIn as well. So, to all your good stewards, thanks for investing time to help your non-profits prosper. We'll connect with you soon on the next episode.

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