DiMeo Schneider & Associates, Nonprofit Investment Stewards Podcast
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Higher Education and COVID-19: Part 3 — With Lawyer Michael Cooney

[00:00:00] Welcome to Nonprofit Investment Stewards with Bob DiMeo and Devon Francis from DiMeo Schneider and Associates, 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.

[00:00:28] Now onto the show. Hello and welcome back to the Non-profit Investment Stewards podcast, I'm Bob DiMeo as always joined by my co host Devon Francis. Today, we conclude our three-part mini series on higher education. And boy has this been timely in part one, we received the lay of the land from Dominican university, president Donna Carroll.

[00:00:51] Then we gleaned terrific insights from the chair of Valparaiso university's investment committee. So if you haven't listened to those, definitely check them out. [00:01:00] But today we conclude with an important topic and a guest who can help you stewards avoid some real issues when it comes to managing endowments to cue it up.

[00:01:10] Let's turn things over to my co-host Devon, Devon, how are you today? Fantastic. Thanks. I'm so excited to hear from our guests today with us, we have Michael Cooney. Who's a partner with the law firm of Nixon Peabody. Mike works with a broad array of charitable organizations and he directs the firm's focus in higher education.

[00:01:29] So certainly he, we would consider him an expert in higher ed matters. He was recently named to the best lawyers in America list in the field of nonprofits. And in 2019, he was named the nonprofit lawyer of the year in Washington, DC. So quite impressive. He also serves on several nonprofit boards, uh, prominent names.

[00:01:50] So he's especially in tune with our listeners. He has. Is that on the same side of the table as you and he's here with us today to share some advice on endowments [00:02:00] some nuances, if you're thinking about greater spending or a draw down, and we may even touch on fundraising, capital campaigns and some other topics.

[00:02:09] So Mike, welcome to the show. Thanks so much for having me. Mike, it's terrific to have you here. And we're really been looking forward to having you on the show before we dive in, perhaps you can tell us how you ended up practicing law and really what makes you so passionate about advising charitable organizations?

[00:02:28] Sure. Well, I am truly blessed. It's a great thing to have your vocation and your avocation so closely aligned. Uh, I was a Russian studies major back during the cold war. Uh, and then, uh, ended up going to law school, found myself in a law firm, figuring I'd be doing international law and was approached by some partners who suggested that I'd already studied the largest nonprofit, the history of the world, the Soviet union.

[00:02:55] So maybe, uh, I could lend some, uh, lend a hand to the nonprofits here in [00:03:00] state side. Wow. That's really interesting. Talk about it. Diverse background, Russian studies. So from your experience in working with your clients and then also serving on nonprofit boards, how would you describe the overall state of endowment and foundation pools in the current environment?

[00:03:19] It really is a tale of two cities. I think really divided up between the charitable grant makers on the one hand and operating charities on the other. I fully expected that the beginning of the pandemic that we were going to see a sizable and sustained market downturn. Akin to 2008 or the.com bust of 1999, the crash of 87 thus far, of course, we've been pleasantly surprised.

[00:03:47] What that means is that, uh, investment earnings have been holding up. And so charitable Grantmakers, uh, have been able to sustain their mission and really enhance it. It's. It's been quite remarkable at [00:04:00] what's been done in the philanthropy sector here in the States. By way of example, we've got five major foundations, uh, Doris Duke, Ford, Kellogg, MacArthur, and Mellon.

[00:04:11] If I'm not mistaken, they've committed to over $1.7 billion over the next three years to nonprofit organizations, charity navigators, the world's largest and most relied upon independent. Surety evaluator on whose board I said, uh, announced its new nonprofit rating system. And it's saying a lot of interest McKinsey and company back in may observed that the flap, the philanthropic, uh, response to the COVID-19 pandemic is shown the sector at its best.

[00:04:41] I think that's truly the case. Now on the other hand is an operating charity. You've got great challenges. The twin effects of unbudgeted costs, flagging income. And so those endowment funds investment funds really becomes so vitally important to be able to sustain your [00:05:00] mission and ride out this storm.

[00:05:04] It really is a tale of two cities, as you say. And we're seeing not only in the higher ed space, but a number of areas where costs and challenges are increasing as you see some demand increasing in some instances. But if we shift to higher ed, perhaps you can talk a little bit about what you see changing regarding endowments and how some of the stakeholders and leadership in higher ed are approaching this.

[00:05:33] So in the higher ed context, uh, we have relied mightily on, uh, earned income undoubted, like charitable giving as a important major component. And then investment returns returns from again, loosely termed endowment. That's a legal term of Bart, but I'll use it here to refer, to invest in funds. Those institutions, which have sizable endowments have been able to rely upon them, even [00:06:00] all the recent market challenges in order to sustain themselves, but even harder as had pandemic losses turning a 300.

[00:06:09] Million dollar plus surplus in 2019 into a $10 million operating Washington 2020. What that says to me is that even the largest endowment here in the us, isn't sufficient to completely protect the entity. We've lost more than 300,000 jobs in higher education since February. And I have every expectation that we're going to be losing more.

[00:06:35] Well, that's a dire picture that you've painted for us, but of course, um, you know, not something that we're unfamiliar with. So, and you've already touched a bit upon this, about the challenges, uh, when you compound lost revenue and then also higher expenses. And in most cases, unexpected expenses from the crisis.

[00:06:56] Okay. So all of this could result in a need for higher [00:07:00] ed institutions or any nonprofit to access additional draws from their endowment, or were similar pools of assets. What are some of the considerations that nonprofit stewards, whether it's investment committees, finance committees, finance directors, executive directors, what are some of the considerations that those folks need to take into account?

[00:07:22] As they think about potentially increased draws from these asset pools. Great question, Devon. So the very first step in my experience. Is that the institution needs to be rock solid on what it is and it actually has. And what do I mean about that? Uh, it's only been a few years now that the accounting profession has displayed charitable investment funds as unrestricted and donor restricted.

[00:07:54] And, and those are the two large buckets that organizations need to think about. [00:08:00] Uh, my experience in doing a restricted fund reviews is that even the best of institutions, uh, deserve a little bit more attention to be sure exactly what donor restrictions may or may not apply to their funding. If the assets are unrestricted, then within the general bounds of prudence, the governing board may extend them.

[00:08:24] And may very well have to considering the current environment and the demands being put upon organizations. With respected donor restricted funds however, it's a very different story because the organization has, uh, the members of the governing board. In fact, have a fiduciary obligation to those donors usually enforced by the state attorney general, to be sure that monies are being properly used.

[00:08:50] Those restrictions, divide themselves up. Generally speaking in the two different groups, use restrictions like scholarship pertaining to a particular use of the funds, [00:09:00] and then timing restrictions such as endowment. Don't spend this entire fund today. Rather invest it in appropriate from a certain draw, calculated, uh, consistent with market conditions and the law and approach it in that way.

[00:09:17] So I think very first issue is know, thyself, know what assets you have. It then becomes a matter of perhaps it's necessary to go back to donors and ask them to relieve or completely undo a gift restriction on a fund who saw the pandemic coming. We're all subject to requirements to demand that, uh, none of us truly expected and donors have been very my experience in the past few months have been very warm to institutions coming to them and asking for relief on fund restrictions, even making new gifts [00:10:00] in cases where donors are not available.

[00:10:02] Of course the institution always has the ability. To go to court sometimes on notice to the attorney general and ask a judge to relieve it, certain restrictions, but those steps really don't need to be taken. Shouldn't be taken until the organization does a full assessment of what it has and decides internally if it can meet its own needs.

[00:10:26] And Mike, I think that could be a sticky wicket, right? If, yeah. If you've got university leaders looking to perhaps up the draw to navigate the crisis and so on and not having that sound okay understanding for sure. So what are some of the ways that you can see endowments appropriately sort of lift the restrictions, work on larger draws?

[00:10:50] What are your recommendations around that? Well, every state in the union, aside from Pennsylvania, which actually I guess, is a [00:11:00] Commonwealth. So, so it has adopted a statute, a uniform act called up the uniform prudent management assets act. And what it does is it sets for two sets of considerations along with respect to investing generally.

[00:11:19] And the other with respect to setting an expenditure rate on true and valid, pure endowment donor endowment. Uh, the first four are the factors under each of the tests are the same. So if you've got the first one dealt with properly, you're well, on the way to dealing with the second. But it's really necessary to go through that exercise and identify what a proper spending rate is today.

[00:11:47] The questions haven't changed the pandemic and all of the subsequent events haven't changed the questions, but certainly the answers are different. Now, the answers are different now than they've ever been. And the organization [00:12:00] needs to take a full and prudence, honest look at the factors and decide how these things play out. Your first and strongest line of defense in terms of dealing with restricted assets is being sure that you've done a good job of meeting your overall requirement improvements.

[00:12:22] Mike, uh, I'll ask you a bit of a second sidebar question here, if you will. And we talk to our university president and our investment chair, university investment chair about this, but you're dealing with leadership at higher education institutions regularly, and investment committees, finance committees.

[00:12:39] What can you recommend, or what observations can you make with respect to what makes for a good committee that really does a nice job of advancing the mission and maybe a, uh, a bit of a disjointed committee. And, and what do you see as the distinction between those two groups? I think [00:13:00] that's a great question.

[00:13:01] And the distinction that I think is the most important is between investment committees or investment functions, no matter where it's conducted in the institution that are, are really somewhat divorced from the needs of the institution versus those which are well aligned with the needs of the institution.

[00:13:22] What do I mean by that? Well for years and years considering, uh, how well the market returns have come, even in terms of setting a budget, it was not uncommon for institutions to almost lock in a spending rate from the investment assets, it was, it seemed all, but assured you've got great investment managers in place.

[00:13:44] Uh, you're taking a, uh, conservative but thoughtful approach. And, uh, you, you end up with a number every year that just gets fed into the budget. That's not the case this year. And so it's really important for the investment [00:14:00] committee function again, wherever located in the institution. To strongly reflect on the factors that indeed are required to be reviewed under the law, if they're relevant.

[00:14:13] And I will tell you they're all relevant, but many of those factors come down to, for example, what are the other resources of the institution? What is the role that the investment plays within the overall investment portfolio of the fund? That link becomes really important. And one of the possible weaknesses that I have seen again, uh, life before COVID 19, there wasn't as much perhaps of a need for the investment committee to understand and associate all of these competing factors as does, for example, a finance committee in creating a budget.

[00:14:59] The a [00:15:00] amount from the endowment was almost a kind of a plugin, but today that can't be the case. So you've got to ask how will the investment committee educate itself on all of these range of factors, which more likely than not your finance committee? Certainly your executive committee is to take it into account.

[00:15:20] So bottom line, there needs to be a greater integration of the investment committee into what's going on within the institution. So Mike that's really resonates. We work with clients on what we call a three lever exercise. What are the inflows? What are the outflows, what are the required return? And it all has to tie to the mission of the institution.

[00:15:42] And then you construct a portfolio that hopefully gives them a fighting chance of achieving their financial goals.

[00:15:51] And have you noticed the change? Well, we're sort of real time here. And I would also say that we have [00:16:00] been pretty diligent about this exercise and really revisiting it on an annual basis with clients. But there is no question that right here and now some of these budget considerations that you mentioned are a challenge.

[00:16:14] Unfortunately, the markets have performed in credibly surprisingly well, right during the pandemic. So everyone is on notice obviously. You've seen a fair amount done on the spending front by a number of universities and other nonprofits. So it's real time and, and it's evolving. And oftentimes I think that we.

[00:16:35] Our interactions with our clients are confined to the investment committee. But I know in my volunteer work with a nonprofit that I serve, I sit on the finance committee and the investment committee, as well as the executive committee and so on and so forth. And it does seem as if the lines between those groups are being blurred, because it's so important for everyone to be, as you said, Mike, [00:17:00] well aware of all of the competing needs and interests.

[00:17:04] And really the full picture of the financial challenges that are afoot. It's a, it's a tough situation. Certainly. So if we go back to the concept of spending and let's say either a, an investment committee, a finance committee, or an organization either doesn't want to, or doesn't have the ability to increase their spending draw in terms of the, the stated spending policy or perhaps they have a significant amount of assets that are donor restricted.

[00:17:37] Are there any other ways to use endowment funds to meet immediate needs? So the one thing that Springs to mind is maybe borrowing against the endowment. Can, can you think of any other ways to access those funds is borrowing or any other kind of other forms of access, something that you [00:18:00] typically dissuade your clients from doing.

[00:18:05] So, let me talk that about self-help. And by that I'm distinguishing the Avenue of going to court to actually have restrictions lifted or modified in a way that makes the assets. Uh, uh, easier to use. And we have in fact done that in cases where the institution wanted to be able to use those assets for borrowing.

[00:18:28] So there are two different self-help approaches that organizations probably will consider. One is borrowing against the endowment, using a third party lender to take a security interest in the endowment as they might with, with real estate or other assets. Or borrowing from the endowment, which is really, uh, an investment approach and investment place.

[00:18:53] So let me speak to each of them, but let me let the cat out of the bag here, uh, that, that [00:19:00] neither of them really is a very satisfactory response to what most organizations want to achieve. First, looking at borrowing against the endowment. The issue there is, is rather straightforward. The governing board in the case of true endowment, right?

[00:19:20] The, the amounts cannot be spent currently cannot be wholly spent curly. You're doing it according to a spending rate. And then with respect to use restricted funds, which may also be endowed, they might not, they have to be used for a particular purpose for a maintenance of the library or whatever the case may be.

[00:19:37] Board governing board cannot access, access those assets. On its own. Now, then what gives it the legal right? To be able to provide a security interest in those assets to a lender. Great question. I've had a number of institutions say to me, well, Mike, the bank, the lender didn't seem too [00:20:00] concerned about it.

[00:20:00] And my response there as well, uh, from a lender's perspective, it's belt and suspenders, whatever assets they can, uh, get some claim to only makes things better. And perhaps that, that question of a bank's willingness to rely or any lenders, willingness to rely shouldn't necessarily answer the question.

[00:20:22] The bottom line is that it is a real challenge for the board to be able to access the spawns in order to be able to hypothecate them or use them as security. The second approach is borrowing from the endowment, which frankly I think is even more fraud. And we've had this case litigated actually all the way up to that.

[00:20:46] Second circuit, which is the circuit, uh, just the Supreme court. And that becomes an investment question. So the organization at this point, doesn't even have the ability to approach a third party lender. Uh, its [00:21:00] credit is not strong enough to do so. And instead the board wants to consider borrowing from the endowment in this difficult time.

[00:21:08] Well, how was that endowment going to be paid back? Governing board has a fiduciary duty to make sure that the spending power of the funds, at least in a true endowment gets maintained is though, is that indeed going to be the case in a situation where the organization is borrowing from its own endowment?

[00:21:31] Is that a good enough credit risk to be able to replenish those funds and replenish the mind you not on a. Cost of doing business, you know, um, uh, taking inflation into account, but really replacing the investment return that it has been enjoying, which up until this point has really rather been strong through the pandemic.

[00:21:55] So just factually it becomes a real challenge, [00:22:00] finding a way to meet one's fiduciary duty while also borrowing from the endowment. Mike, those are absolutely wonderful nuanced insights and it's something I think I'm sure our listeners will appreciate. We do want to take a moment to talk about capital campaigns, capital expenditure.

[00:22:19] Before we jump to that, anything else you'd like to share with respect to endowments, with respect to ask accessing funds and just overall good stewardship as it pertains to overseeing endowments. I've always been a strong proponent, certainly within the organization and even so with one's an institution's donor population for a high level of transparency.

[00:22:45] There are certain States which require reports to the governing board on the use of donor restricted funds over the past year. Even the jurisdictions that don't require that my strong suggestion is that that practice [00:23:00] be adopted so that the governing board, or again, some subset of it could be a board committee is responsible and is informed as to how the institution is doing with respecting to meeting its obligation, to using these funds for what they were intended.

[00:23:21] That sends a strong message as well to current donors who have many, many options in terms of donating their funds, donor advised funds so popular now, um, much, much more popular in recent years. Well, what's going to move someone to make a gift to their higher education institution. It's going to be confidence in what the institution is going to accomplish and in particular competence in how.

[00:23:50] That particular dollars funds get used. So you ready to tell the story and, uh, make it a good one? You're you're absolutely spot on [00:24:00] in everything you've been saying. So moving to the, the topic that Bob kind of teed up, what do you think nonprofit leaders should be thinking about given the current environment when it comes to launching a capital campaign or maybe following through with the capital campaign that's already been launched?

[00:24:20] Well, I think at this point in time, there's, there's a greater need for available assets in the charitable sector, uh, than ever, certainly in my 30 plus years of practice, the organization has an obligation to make it plain to the donor population, what it needs those assets for and how they're going to be used.

[00:24:41] So I I'm, I'm a firm believer that even in the darkest times, it's important to keep up a rapport. With one's donor population, they're your partners in making whatever charity you're involved in, whether it's education, the arts, social [00:25:00] services, making those things happen and best that they be treated that way.

[00:25:06] That being said, I think it's very important at this point in time to look at the goals of capital campaigns. And to be brutally honest as to how they may have changed or might need to change. As one goes out to the giving market. As I mentioned at the onset, there are a lot of foundations. There are a lot of donors who are incredibly generous, even more generous now than they'd been in the past, considering everything that's going on.

[00:25:37] But the nature of fundraising, I think needs to change. And in what light, uh, transparency, again, hugely important remake the commitment there, but I think conversations need to be had with donors about donor restrictions, because in many cases they can truly hamstring an [00:26:00] organization in ways that, you know, upon a second review, a donor might not actually intend as you see how things play out.

[00:26:09] Uh, in the realities of the market today. So I would want to be very, very clear, very thoughtful about techniques used to raise the money and how donor restrictions are going to be recognized and realized. Mike, that's so helpful. And all of your advice has been so helpful. We're grateful for that. Before we wrap things up, maybe a little bit about Mike Cooney, the person, and just curious when you're not working and providing Sage advice to your clients, what do you do for fun?

[00:26:42] And if possible, right? 2020 has been a challenging year, but hopefully you've been able to find a silver lining or to please share what you do for fun in a silver lining that you might've experienced this year. Well, I spent a good amount of time, uh, with my, uh, trusty guitar and [00:27:00] the jazz guitarist. And so it's nice to be able to keep it close by and, uh, get some well well-needed practice.

[00:27:08] And I'm also a bicyclist and, uh, it's a great thing to be able to get outside and get on the roads and riding Sheila. It's time to come home. I think the greatest thing for me, frankly, with respect to the pandemic and all the changes, all the awful cost it's imposed on all too many of us is that, uh, I've been able to spend more time with my family, which in an above all things is probably the best thing that one can hope for in a situation like this, that we found ourselves in.

[00:27:42] Yes, absolutely. I think a lot of us share that same silver lining that the quality time with family is, um, something that's been missed, you know, among the hustle and bustle of kind of quote unquote normal life. And it is certainly a welcome, welcome [00:28:00] change from, from the old way of life. So thank you, Mike, for coming on the show today, you have been so insightful and have really given us a holistic view of what it means to be a good steward and all of the nuances that one must consider when thinking about possibly making a special draw from an endowment.

[00:28:21] Committees should be thinking about. Um, so really your insight has been so appreciated. If a listener wants to reach out to you, can you tell them how to get in touch? Uh, most certainly, uh, easy enough to reach me@mcooney@nixonpeabody.com. Look forward to speaking with folks about this very important topic.

[00:28:45] Mike that's terrific. And thank you so much on behalf of Devon and the entire firm. As we wrap up three things for our listeners. One, remember to subscribe to the show and know that we welcome your reviews. Next, if you have a topic you'd like us to address, or if you or [00:29:00] someone, you know, would be a great guest, reach out to me or Devon via LinkedIn.

[00:29:04] And finally, if you are a leader at a nonprofit, maybe serve as a board or a committee member, and you hope to explore strategies. To potentially better manage the investments you oversee feel free to contact me or Devon and certainly visit dimeoschneider.com, where you will find an array of great resources.

[00:29:22] So to all you good stewards. Thanks for investing time to help your nonprofits prosper. We'll connect soon with you on the next episode. Thank you for listening to the non-profit investment stewards podcast. Click the subscribe button below to be notified of new episodes and visit DiMeo Schneider dot for more information, the information covered and posted represents the views and opinions of the guest and does not necessarily represent the views or opinions of DiMeo Schneider and associates.

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