



SUBJECT	SUSTAINABLE FUTURE POOL – SPEND RATE
MEETING DATE	FEBRUARY 12, 2019

Forwarded on the Recommendation of the President

APPROVED FOR SUBMISSION

Santa J. Ono, President and Vice-Chancellor

DECISION REQUESTED	<p>IT IS HEREBY REQUESTED that <i>approval be granted for:</i></p> <ul style="list-style-type: none"> <i>i. donor contributions to the Sustainable Future Pool, an increase in the spend rate to 3.75%, by reducing the administrative charge to 0.40%, for a period to two years effective April 1, 2019;</i> <i>ii. UBC contributions to the Sustainable Future Pool, retention of the spend rate and administrative charge at 3.5% and 0.65% respectively; and,</i> <i>iii. Implementation of an annual Sustainable Future Pool spend rate review, including a comprehensive review by or before March 31, 2021.</i>
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Report Date	January 11, 2019
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Presented By Peter Smailes, Vice-President Finance & Administration
 Rajiv Silgado, President & Chief Executive Officer, UBC IMANT
 Tor Album, Acting Treasurer

EXECUTIVE SUMMARY

The UBC Board of Governors approved the creation of the Sustainable Future Pool (“SFP”) in February 2017 with an initial contribution of \$10 million from the Trek endowment to establish the Trek Impact Endowment Fund in the SFP. The Board of Governors also committed to contributing an additional \$5 million per year for three years to the Trek Impact Endowment Fund provided that the performance of the SFP is not materially adverse as compared to the Main Endowment Pool. The first of these \$5m contributions was approved by the Board of Governors in April 2018.

At establishment of the SFP it was contemplated that the size of the pool and lack of broad diversification could lead to investment returns that are more volatile than the Main Endowment Pool. Consequently the initial spending rate was set at 3.5%, 0.5% lower than the Main Endowment Pool.

To generate its 3.5% spend rate while maintaining the real value of the assets, SFP’s portfolio needs to generate a return of 6.15% per year. This includes the annual inflation expectation of 2.0% and an additional 0.65% for costs related to the operation of the pool (“administrative charge”).

IMANT carried out a review of expected returns across asset classes to understand if the SFP spending rate could be raised to 4%. The SFP asset mix is consistent with the risk return profile and the objectives of the fund. Any changes to the asset mix within the risk return profile and within available investment options would not have a

material impact on returns. The analysis of expected and actual returns, combined with the continued lack of size, lack of diversification and limited track record, do not justify an increase to the spend rate.

The recommendation is that the spend rate of 3.5% and the corresponding administrative charge of 0.65% are retained for UBC’s contributions to the SFP (“Trek Impact Endowment Fund”).

Donor Funds in the SFP

As of November 30, 2018, donor contributions represent 0.76% of the capital in the SFP through only two endowment funds.

The recommendation is therefore to lower the administrative charge to 0.40% for existing and future donor contributions, for a period of up to two years, effective April 1st, 2019, to provide another 25 basis points to the spend rate from 3.5% to 3.75%. At the end of the trial period, the University will review the financial situation of the Fund, and the impact this has had on donor contributions, and decide whether to extend or discontinue the reduction. The goal would be to increase the spend rate to 4% over time, based on projected investment returns.

Although there is some precedence in the Main Endowment Pool, with a few large endowment funds being charged lower administrative charges, lowering the administrative charges further for external donors would be precedent setting, and difficult to reverse in the future.

Lowering the administrative charge is recommended for a limited time period, to evaluate whether the increased spend rate has a desired effect, before making decisions about future spend rates.

It is further recommended that a comprehensive review regarding a future spend rate for the SFP, including both UBC and donor contributions, is undertaken before the end of fiscal year 2021. A two year commitment to increase the spend rate for donor contributions will also coincide with the current commitment from the Board of Governors to contribute \$5m per year for another two years to the SFP.

STRATEGIC CORE AREAS SUPPORTED

- ✓ People and Places
✓ Research Excellence
✓ Transformative Learning
✓ Local / Global Engagement

DESCRIPTION & RATIONALE

Background

UBC is committed to sustainability in endowment investments. In 2013, UBC adopted its Responsible Investment Policy to direct UBC to consider environmental, social and governance (“ESG”) factors to make more informed investment decisions for the UBC Endowment. Such ESG factors have now become an integral part of the manager selection process for the Main Endowment Pool (“MEP”).

The Sustainable Future Pool (“SFP”) was established as a result of a call for divestment of fossil fuels in by students and faculty in 2015. The University received legal advice that divestment of the UBC Main Endowment Pool from fossil fuels was inconsistent with UBC’s fiduciary responsibilities.

Establishing the SFP is an important part of UBC’s commitment to sustainability. The SFP pursues sustainability concepts beyond the progressive strategies already being incorporated in the Main Endowment Pool and has reduced or no fossil fuel investments (currently it has none) and target lower carbon emissions.

It brings together UBC’s mandate of inquiry and the creation of knowledge, UBC’s desire to lead from within, its academic experience, research expertise, and operations management to make the university a living lab - and to use what UBC learns to benefit its communities.

The UBC Board of Governors approved the establishment of the SFP at the February 2016 meeting, the SFP Statement of Investment Policies & Procedures at the September 2016 meeting, and a \$10 million contribution from the Trek endowment to create the Trek Impact Endowment Fund in the SFP in February 2017.

The Board of Governors also committed to contributing an additional \$5 million per year for three years to the Trek Impact Endowment Fund provided that the performance of the SFP is not materially adverse as compared to the Main Endowment Pool. The first of these \$5m contributions was approved by the Board of Governors in April 2018.

The SFP targets an asset mix of 70% global equities and 30% Canadian bonds, with an option to include green bonds. The SFP is invested in two pooled fund vehicles with a single manager. Both funds (equities and bonds) have materially lower carbon dioxide emissions than the established benchmark resulting from the fossil fuel exclusions and emphasis on CO2 emissions reductions by portfolio companies.

Legal considerations

The main difference between the Main Endowment Pool and the SFP is that the Main Endowment Pool must be invested strictly in the best interests of charitable purpose trusts, which is their financial interests, and the SFP must be invested in the best interests of the university, which may take some broader criteria into account. The SFP is comprised of the university's own monies and also donor monies where the donors have specifically agreed to the investment SFP criteria.

When exercising its fiduciary responsibilities for the SFP, the University has determined that the non-financial criteria of carbon emissions is in the best interest of UBC for the following reasons:

- UBC is a place of research and will be using SFP as part of its living lab to see if a higher level of sustainability can be incorporated into its investment processes in a prudent manner;
- UBC has a long-term focus and sustainability is a core value;
- the SFP is in a separate pool so that UBC can track its results clearly;
- the SFP opens up an investment choice to donors; and
- it provides reputational impacts to UBC amongst its students, faculty, and donors.

Given the experimental nature of the SFP and UBC's fiduciary responsibilities, UBC must maintain the ability to adjust the investment profile of the SFP. This includes the potential to transfer SFP funds to another Endowment Pool at UBC and/or discontinue the SFP if the BOG determines that it is in the best interest of UBC.

The advice from legal counsel is donor funds can be added to the SFP only where they specifically agree that their gifts will be invested in the best interests of UBC and in a manner that takes non-financial considerations into account.

Development and Alumni Engagement Considerations

Development and Alumni Engagement (“DAE”) will continue to expand awareness of the SFP to the UBC frontline fundraisers and academic partners to ensure that donors making a gift to establish a new endowment are provided the SFP as an option.

DAE anticipates that the SFP will continue to grow, however it will likely be modest growth and it will take time for the following reasons:

- Major gifts are made when a donor’s passion intersects with a University priority. When donors contemplate the SFP, they must accept that UBC will be taking both financial and non-financial considerations into account when UBC invests their gift, which means UBC will be considering interests other than the best interest of their passion when UBC invests their gift.
- Many donors to endowments have previously given to other UBC endowments in the Main Endowment Pool and are satisfied with the ESG principles applied to their past gifts. UBC must ensure that our past donors are proud and fulfilled by their decision to donate to the endowment that is invested in the best interest of their charitable purpose, which includes only financial considerations.
- The business cycle of establishing a new endowment – from initial discussions with the prospective donor to the fund being approved by BOG and established – is often 2+ years, many of the endowments recently established pre-date the inception of the SFP.
- Many of the contributions made to endowment funds in a given fiscal year are pledge payments or renewed gifts to pre-existing endowment funds, it will take time to develop repeat and recurring donation histories with new funds.

Spend Rate

At the time of establishment of the SFP it was contemplated that the small size of the pool and lack of broad diversification could lead to investment returns that are more volatile than the Main Endowment Pool. Consequently the initial spending rate was set at 3.5%, 0.5% lower than the Main Endowment Pool. The SFP has been operational for less than two years, and it is still early to draw conclusions with regards to the longer term implications of the asset-mix and non-financial considerations.

Performance

The current market value of the SFP is just over \$15m. The largest endowment fund is the UBC Trek Impact Endowment Fund, which represents the \$15m contributions to date from UBC. At present there are only two external endowment funds (donors) which collectively represent 0.76% of the Pool (see table below).

Sustainable Future Pool - November 30, 2018				
Source of contribution	Ending Capital Balance	Ending Stabilization Balance	Market Value - Nov 30 2018	Endowment Funds
Internal	15,000,000	(47,338)	14,952,662	UBC Trek Impact
External	74,555	1,988	76,543	Donor 1
External	39,600	(1,608)	37,992	Donor 2
SUM	15,114,155	(46,959)	15,067,196	

Preliminary return estimates to the end of 2018 suggest that, despite its limitations, the SFP has delivered strong relative performance versus its benchmark of 70/30 global equities and Canadian bonds.

Since inception the fund has outperformed its policy benchmark by 148 basis points gaining 5% vs. 3.5% for the benchmark. In calendar 2018, the SFP outperformed its benchmark by 195 basis points delivering 2.2% versus 0.2%.

Nonetheless, those returns are still lower than SFP's required rate of return of 6.15% per annum, and as the table above indicates, the current market value of the Pool is lower than its capital contributions (negative stabilization account).

Quantitative Considerations

To generate its current 3.5% spend rate while maintaining the real value of the assets, the SFP portfolio needs to generate 6.15% per year. This includes the annual inflation expectation of 2.0% and an additional 0.65% for costs related to the operation of the pool ("administrative charge").

When established, the longer term outlook for the asset mix supported the long term required return of 6.15%. However, based on the recent long-term asset class assumptions employed in 2017's Staff Pension Plan asset mix review (the most current available to IMANT without undertaking an expensive full review), the 70/30 benchmark portfolio for the SFP is now expected to grow by only 5.5% annually, which is below previous expectations. Given the manager's outperformance of the benchmark, a 6.15% is still supportable.

Considerable market movement during 2018 and more recent market declines are likely to have impacted return expectations for various asset classes going forward. Those revisions may justify the possibility of later spend rate increases. As these updated return estimates are being obtained, IMANT will provide an update on the impact of those revisions on SFP's expected returns and spend rate.

IMANT carried out a review of expected returns across asset classes to understand if the SFP spending rate could be raised to 4%. The SFP asset mix is consistent with the risk return profile and the objectives of the fund. Any changes to the asset mix within the risk return profile and within available investment options would not have a material impact on returns.

The analysis of expected and actual returns, combined with the continued lack of size, lack of diversification and limited track record, do not justify an increase to the spend rate at this time.

Administrative Charge Reduction

As opposed to looking to the assets to support a higher spend rate, another approach is to lower the administrative charge. For the SFP, this would imply lowering the administrative charge from 0.65% currently charged to the SFP to free up additional basis points that can be added to the spend rate. The "cost" to the university would be the foregone administrative charge, but this is manageable given the proposed finite term of the change.

At present the administrative complexity and cost of managing the SFP is minimal, with only three endowment funds, compared to 3,500 endowment funds in the Main Endowment Pool.

Although there is some precedence in the Main Endowment Pool, with a few endowment funds being charged lower administrative charges than the rest, the administration is concerned that lowering the administrative charge further for external donors would be precedent setting, and difficult to reverse in the future.

Therefore, the recommendation is that the reduction in the administrative charge be for a limited time period, followed by a comprehensive review towards the end of this period, to evaluate whether the increased spend rate has a desired effect, before making decisions about future spend rates.

Recommendation

Based on the discussion above, the administration recommends the following:

- The spend rate and administrative charge for UBC’s contributions to the SFP (Trek Impact Endowment Fund), are retained at 3.5% and 0.65%.
- The spend rate for donor contributions invested in the SFP is increased to 3.75%.
- This increase in spend rate is “funded” by lowering the administrative charge for donor contributions from 0.65% to 0.40%.
- The change in spend rate/administrative charge for donor contributions will be in effect for two fiscal years (effective April 1st, 2019) and considered a trial period. This period will also coincide with UBC’s commitment to contribute \$5m per year to the SFP for an additional two years.
- The spend rate for the SFP will be subject to annual reviews, and a comprehensive review of a future spend rate for the SFP will be required before the end of the trial period.

BENEFITS

Learning, Research,
Financial,
Sustainability &
Reputational

The SFP is an important part of the University’s commitment to sustainability and brings together the University’s mandate of inquiry and the creation of knowledge, its desire to lead from within, its academic experience, research expertise, and operations management to make the University a living lab.

A higher spend rate has the potential to increase the impact of each donor contribution to support the charitable purpose of those donations.

RISKS

Financial,
Operational &
Reputational

The size of the SFP impacts the ability to diversify investments and leads to greater exposure to equity markets. This may lead to greater volatility of returns, as compared to a larger, more diversified pool.

The long-term asset class assumptions employed in 2017’s Staff Pension Plan asset mix review (the most current available to IMANT without undertaking an expensive full review) suggested that the 70/30 benchmark portfolio in the SFP is now expected to grow by only 5.5% annually, which is below previous expectations and below the current required return of 6.15%.

Financing the increased spend rate for the SFP by lowering the administrative charge helps mitigate risks associated with the longer term expected return assumptions. Retaining the spend rate and administrative charges for UBC contributions help mitigate short term risks.

COSTS
Capital & Lifecycle
Operating

The foregone administration charges for the current composition of the SFP is marginal at less than \$300 (see below). Any foregone administrative charges will be matched by equivalent increases in spending allocations in support of the purposes of the specific funds.

Source of contribution	Endowment Funds	Market Value - Nov 30 2018	Current Administrative Charge		Differentiated Administrative charge	
Internal	UBC Trek Impact	14,952,662	0.65%	97,192	0.65%	97,192
External	Donor 1	76,543	0.65%	498	0.40%	306
External	Donor 2	37,992	0.65%	247	0.40%	152
SUM		15,067,196		97,937		97,650
						(286)

In a scenario where the increased spend rate attracts \$5m of contributions in FY20 and \$10m in FY21 (see tables below), the foregone administrative charges (compared to as-is) increase to \$13.5k in year 1 and \$40.5k in Year 2. These amounts are still relatively immaterial, compared to the overall administration charges derived from the two endowment pools.

Source of contribution	Endowment Funds	Market Value FY19	Expected Contribution FY20	Market Value FY20	Current Administrative Charge		Differentiated Administrative charge	
Internal	UBC Trek Impact	14,952,662	5,000,000	21,179,750	0.65%	137,668	0.65%	137,668
External	Donor 1	76,543		81,250	0.65%	528	0.40%	325
External	Donor 2	37,992		40,328	0.65%	262	0.40%	161
External	New Donors X-Y	-	5,000,000	5,307,500	0.65%	34,499	0.40%	21,230
SUM		15,067,196		26,608,828		172,957		159,385
								(13,573)

Source of contribution	Endowment Funds	Market Value FY20	Expected Contribution FY21	Market Value FY21	Current Administrative Charge		Differentiated Administrative charge	
Internal	UBC Trek Impact	21,179,750	5,000,000	27,789,805	0.65%	180,634	0.65%	180,634
External	Donor 1	81,250		86,247	0.65%	561	0.40%	345
External	Donor 2	40,328		42,808	0.65%	278	0.40%	171
External	New Donors X-Y	5,307,500	10,000,000	16,248,911	0.65%	105,618	0.40%	64,996
SUM		26,608,828				287,091		246,146
								(40,945)

FINANCIAL
Funding Sources,
Impact on Liquidity

At a current market value of \$15.1m the SFP represents a little below 1% of the Main Endowment Pool, valued at \$1.7 billion.

The Board of Governors have committed to contributing an additional \$5 million per year for two more years to the Trek Impact Endowment Fund provided that the performance of the SFP is not materially adverse as compared to the Main Endowment Pool.

SCHEDULE
Implementation
Timeline

The recommended changes would take effect from April 1st, 2019

CONSULTATION
Relevant Units,
Internal & External
Constituencies

UBC IMANT
Treasury
Office of the University Counsel
Development and Alumni Engagement
Budget Office
Endowment Accounting.

Previous Report Date	April 19, 2018
Decision	Approval of an additional transfer of \$5 million to the Sustainable Future Pool and retain the spend rate at 3.5%.
Action / Follow Up	
Previous Report Date	April 13, 2017
Decision	Amendment to Policy #113, Endowment Management related to the establishment of the SFP.
Action / Follow Up	
Previous Report Date	February 14, 2017
Decision	Agreement to establish the SFP with \$10 million internal Trek funds and approval of the SFP Statement of Investment Policies and Procedures.
Action / Follow Up	