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| SUBJECT | Main Endowment Pool Spending Rate FY2024 |
| SUBMITTED TO | Finance Committee |
| MEETING DATE | November 17, 2022 |
| SESSION CLASSIFICATION | Recommended session criteria from Board Meetings Policy: OPEN |
| REQUEST | APPROVAL REQUESTED IT IS HEREBY RESOLVED that the Finance Committee recommends that the Board of Governors approve retention of the Main Endowment Pool spending rate at 4.0% for FY2024. |
| LEAD EXECUTIVE | Yale Loh, Interim Vice-President Finance |
| SUPPORTED BY | Dawn Jia, CEO, UBC Investment Management Gordon MacDougall, Chair, UBC Investment Management Board Graham Sheppard, UBC Investment Management Doug Cheung, Director, Treasury Matt Boydston, Interim Comptroller |

PRIOR SUBMISSIONS

The subject matter of this submission was most recently considered by the Board of Governors on [November 19, 2021](#) – Endowment Asset Mix Review – Reference Portfolio and Spend Rate Recommendation.

The following Executive Summary provides a status update from the date of the most recent submission.

EXECUTIVE SUMMARY

In accordance with Endowment Management Policy FM5, the spending rate for each of the endowment pools is established by the Board of Governors annually based on advice from the Administration and UBC Investment Management. In addition to the annual review, an asset mix review is conducted every three to five years by UBC Investment Management to assess the ability to preserve intergenerational equity, the outlook for long term investment returns and ultimately the spending rate.

The last asset mix review was completed in 2021 where UBC Investment Management’s reference portfolio Investment Framework was presented and subsequently approved. Given the cyclical nature of financial markets, aggregate stabilization ratios are expected to vary over shorter periods but to generally trend towards the 105% target range over the long term. As at September 30, 2022, there were approximately 3,800 endowment funds in the MEP with an aggregate stabilization ratio¹ of 110%, down from 123% at September 30, 2021. The decrease in stabilization ratio was primarily driven by high inflation experienced over the last year, along with the market downturn negatively impacting investment returns.

¹ The stabilization ratio is defined as the ratio of the market value of assets to inflation-adjusted value of endowment capital for an individual endowment. The aggregate stabilization ratio is calculated using the aggregate market value and inflation-adjusted capital in consideration of the entire endowment.

| Date | Number of Endowments ¹ | Inflation Adjusted Capital Account (000's) | Stabilization Account (000's) | Average Stabilization Ratio |
|-----------|-----------------------------------|--|-------------------------------|-----------------------------|
| 31-Mar-20 | 3,651 | 1,133,553 | 105,708 | 109.3% |
| 31-Mar-21 | 3,700 | 1,209,314 | 227,441 | 118.8% |
| 31-Mar-22 | 3,771 | 1,317,498 | 232,345 | 117.6% |
| 30-Sep-22 | 3,800 | 1,362,452 | 133,605 | 109.8% |

¹ Excludes TREK and Killam Endowment Funds

UBC Investment Management analysis estimates that with a starting aggregate stabilization ratio of 110%, the current Reference Portfolio's estimated probability of sustaining the 4.0% spend rate over 15 years is 47% (51% in 2021). The stronger diversification and higher return profile of the Strategic Portfolio improves the estimated probability to 57% (67% in 2021).

It is worthwhile noting that in the 2021 asset mix review, given the high 119% starting stabilization ratio as at March 31, 2021, a Reference Portfolio was recommended that would intentionally draw down the stabilization ratio buffer toward the target level of 105% over a period of 15 years. While the drawdown in financial markets and the surge in inflation was not forecasted, the strong position of the MEP going into the last year has still left it in a position to retain the existing spend rate in FY2024 while financial market developments are being monitored closely.

Given the aggregate stabilization ratio of 110% at September 30, 2022, is above the target range, the administration believes it is appropriate to retain a spending rate of 4.0% for FY2024 as it balances the financial health of the endowment while acknowledging the ongoing market challenges in the short to medium term.

It should be noted that a scenario of persisting elevated levels of inflation and/or further declines in financial markets may threaten the sustainability of the current spend rate for future years (beyond FY2024) and may require the Board of Governors to consider other options. Developments will continue to be closely monitored and reported to the Board of Governors.

As the aggregate MEP is above the target range, it is proposed that the Board of Governors approve a spend rate of 4.0% for FY2024. The MEP spend rate will continue to be reviewed on an annual basis, while the stabilization ratio of the MEP and financial markets are monitored closely by UBC Finance and UBC Investment Management through the year.

PRESENTATIONS

1. Main Endowment Pool FY2024 Spend Rate Recommendation

Main Endowment Pool FY2024 Spend Rate Recommendation

November 17, 2022

Yale Loh, Interim Vice-President Finance

Dawn Jia, President & CEO, UBC Investment Management



SPEND RATE RECOMMENDATION

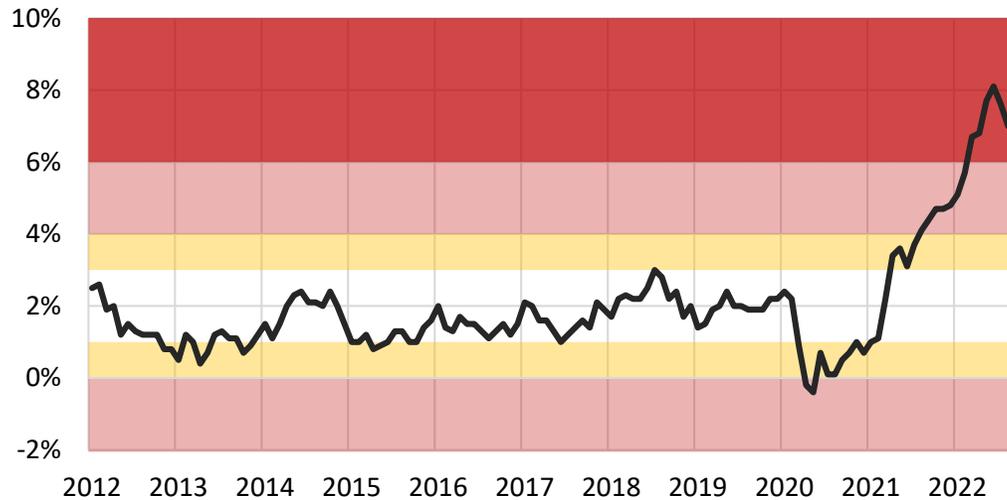
The administration is recommending a spend rate of 4.0% for the Main Endowment Pool (“MEP”) for FY2024 (No Change from FY2023):

- Higher-than-forecast inflation and negative financial market returns have had a downward impact on the aggregate stabilization ratio. The estimated aggregate average stabilization ratio of the MEP dropped to 110% at September 30, 2022 (September 2021 – 123%).
- Long-term, forward-looking investment return expectations have increased as a result of the recent market drawdown. However, near term economic and financial market developments remain uncertain and will be closely monitored.

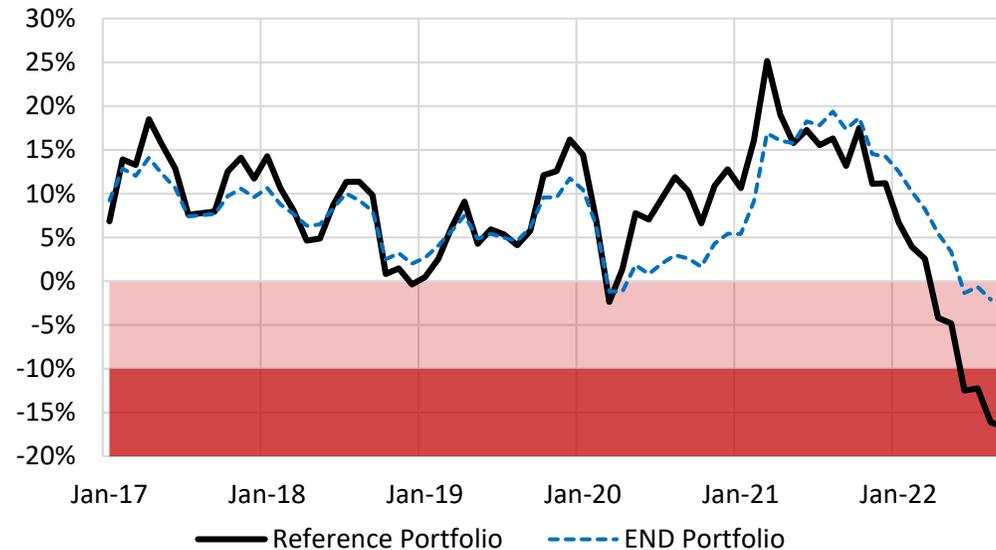


FY2023 FINANCIAL MARKET DEVELOPMENTS

Canadian Inflation (Year-over-Year)



Investment Market Returns (1-Year Rolling Periods)

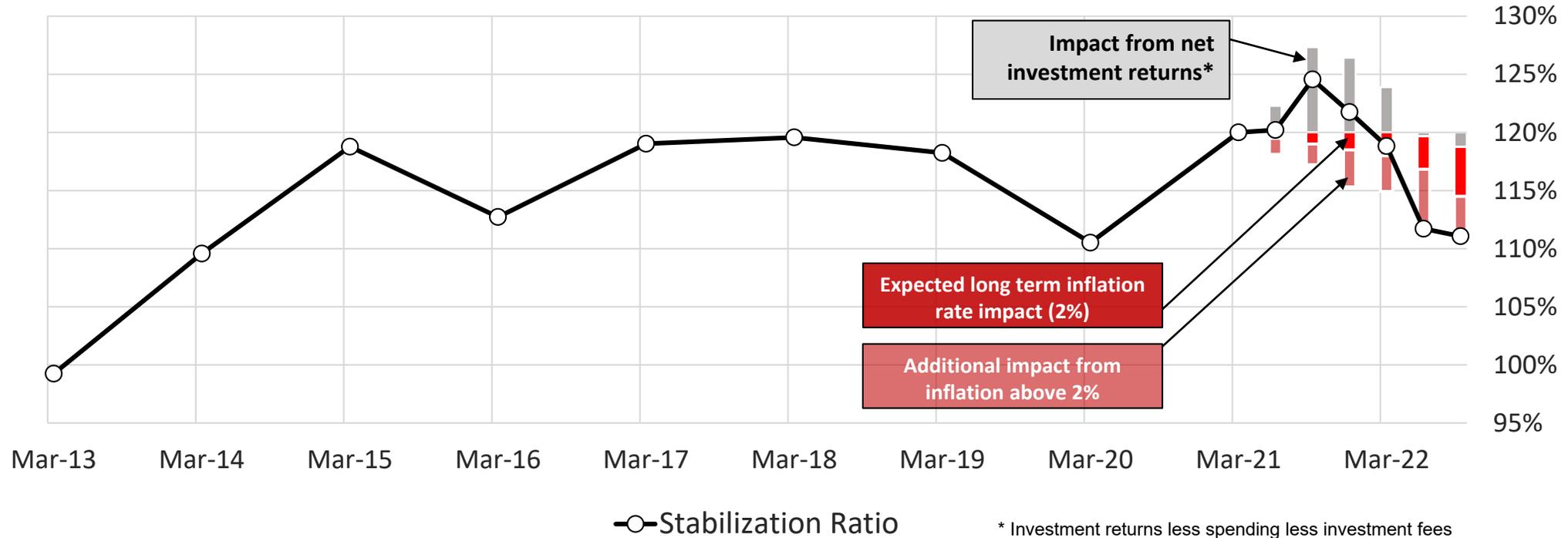


- The Endowment experienced a challenging environment due to the surge in inflation and the sharp downturn in financial markets; both negatively impact the stabilization ratio.
- The MEP portfolio has outperformed the Reference Portfolio, enabling the MEP to maintain the current spend rate for FY2024. An extended period of high inflation and low financial market returns may threaten the sustainability of the spend rate for future years (beyond FY2024).



MEP STABILIZATION RATIO TREND

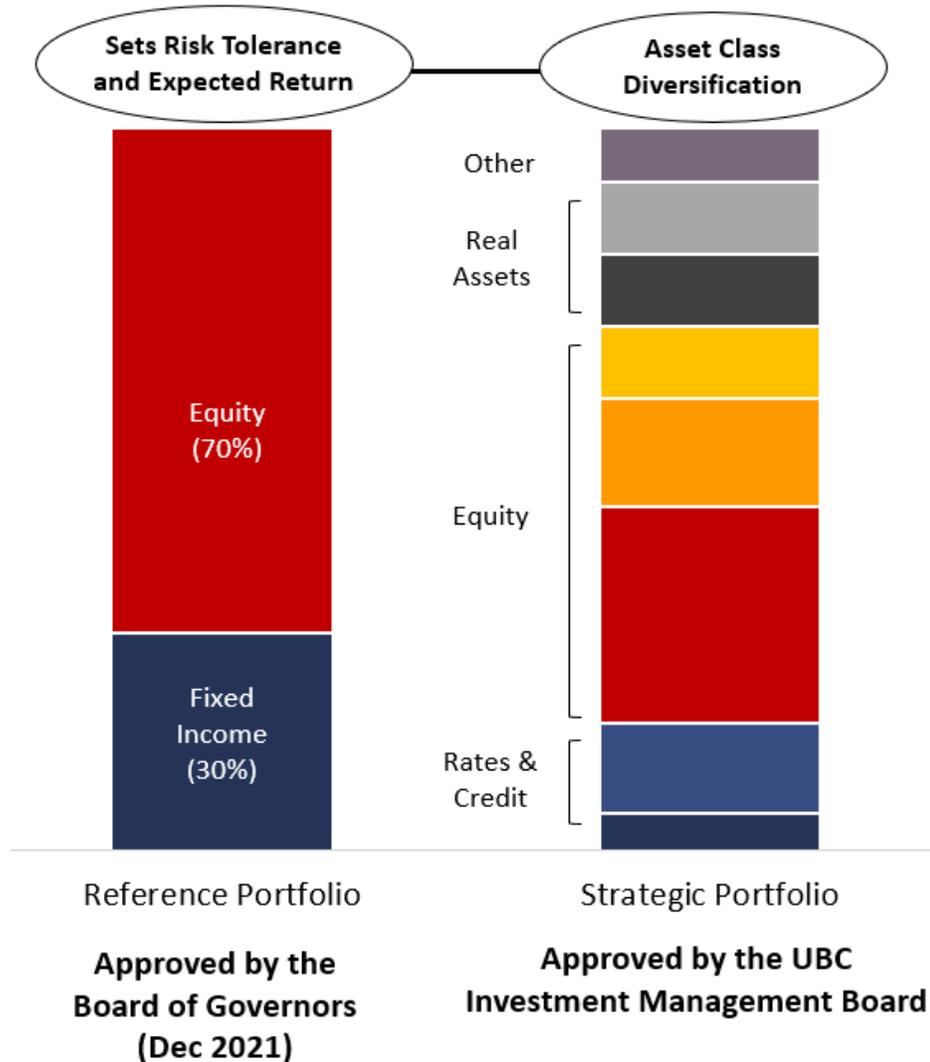
Main Endowment Pool Stabilization Ratio (Cumulative Impact)



- The MEP stabilization ratio has decreased from 123% in September 2021 to 110% in September 2022. This has been primarily driven by historically high inflation levels.



RECAP OF THE REFERENCE AND STRATEGIC PORTFOLIOS



- The Reference Portfolio sets the investment risk tolerance and expected return profile of the Endowment.
- The Strategic Portfolio is expected to outperform the Reference Portfolio over the long term, increasing the probability that the Endowment spending is sustained.



FY2024 SPEND RATE KEY ASSUMPTIONS

| Metric (annualized) | 2021 Spend Rate Assumptions (15-Year) | 2022 Spend Rate Assumptions (15-Year) |
|--|---------------------------------------|---------------------------------------|
| Canadian Inflation: (15-Yr) | 1.7% | 2.3% |
| Reference Portfolio: Expected Return (15-Yr) | 5.5% | 6.5% |
| Strategic Portfolio: Expected Return (15-Yr) | 6.9% | 7.5% |
| Starting Stabilization Ratio | 119% | 110% |

- Negative financial market returns in 2022 has improved the forward-looking return expectations for the Reference Portfolio and Strategic Portfolio. This is offset by higher inflation forecasts and the lower starting stabilization ratio.
- The current Reference Portfolio seems to be able to support the existing spend rate in FY2024, however further reduction in the Stabilization Ratio may require the considerations of other options.

