Endowment Investment Objectives, Policies, and Implementation Guidelines

(original October 2007, updated and approved by GB on July 22, 2021)

1. **<u>Endowment and financial stability objective</u>**

   The Archaeological Institute of America's (AIA) primary objective for the endowment policies is to preserve or, if possible, to enhance the purchasing power of the endowment's assets over time to at minimum maintain the endowment's ability to support AIA's activities. The endowment's annual support should be reasonably stable and to that end, both spending policy and asset allocation, as noted below, should be prudent.

   Generally, application of the following policies is the responsibility of the Chief Financial Officer or highest-level finance staff of the AIA, oversite is the responsibility of the Finance Committee, under the direction of the Treasurer.

2. **POLICY: Unrestricted, Board designated, reserve**

   The AIA should maintain a level of unrestricted funds sufficient to provide for unforeseen requirements. In this case, the appropriate level should provide financial coverage against unexpected short-term fluctuations in revenues. Without such funds, any need to cover unforeseen obligations would require invading temporarily or permanently restricted funds, usually in violation of the donor's intentions.

   Based on review of historical short-term revenue fluctuations experienced by the AIA, the staff recommends the appropriate amount would be 25% of budgeted operating revenues. In other words, an amount providing coverage of 2.5 times a potential 10% decline in revenues. The quasi-endowment *Fund for the AIA* was established to serve this purpose, and along with other unrestricted net assets, should maintain a balance equal to 0.25 * gross revenue per the fiscal year budget.

3. **POLICY: Liquidity or cash reserve**

   The AIA should maintain a sufficient level of cash to respond to varying economic conditions and changes affecting the AIA's financial position and ability to continuously carry out its mission. During times of economic uncertainty, it is important that AIA continuously provide stable support of annual operations such as compensation, program expenses, rent, utilities, etc. The liquidity, or cash, reserve requirement is intended to preserve stable operations and most programing for a limited time without the need to sell assets during market volatility. For this reason, the AIA should maintain a minimum cash reserve balance equal to 25% of budgeted operating expenses.

4. **<u>Endowment spending objective</u>**

   To preserve or enhance the purchasing power of the endowment's assets over time, the spending draw must be below the sum of the net investment income after returns, expenses, and the inflation rate. The spending rate, draw calculation, return objectives, and asset management policies are structured in a way that attempts to minimize the year-to-year volatility of the amount available for spending.

   When the AIA accepts endowment gifts that are restricted (either time restricted or use restricted), those restrictions will be fulfilled to the extent permitted by law. The AIA undertakes the management and spending of endowment funds with considerable care and honors the special position of trust and responsibility bestowed by donors.

5. **POLICY: Spending rate**

   Given the long-term nature of the endowment, recent periods of extraordinarily high and volatile returns cannot provide useful guidance for spending. Over very long periods, institutions spending more than 5% of endowment assets annually tended to lose purchasing power. Thus, AIA's objective is for the spending rate to be 5%.

6. **POLICY: Endowment draw calculation**

   Even with conservative asset allocation, as noted below, short-term movements in equity or fixed income markets can affect the current market value of the endowment's assets, and thus potentially, the annual support the endowment provides. To achieve reasonable stability of support, and to take account of the long-term average peak-to-trough periodicity of market behavior, AIA's spending rule would be to apply the spending rate to a trailing 12-quarter average of the endowment's market value.

7. **POLICY: Deductions and expenses**

   7.1. Endowment draw: Calculated from AIA's spending rule by applying the spending rate to a trailing 12-quarter (3-year) average of the endowment's market value, excluding fund balances that use a separate spending rule or will not take a draw in that fiscal year. That draw amount is allocated across the funds included in the calculation based on the funds' ratio within the endowment balance. The appropriated endowment draw-by-fund becomes the AIA's spending budget to fulfill the programs supported by the endowment funds.

7.2. Principal draw: Deductions may be made from unrestricted and temporarily restricted endowment assets, but never permanently restricted assets. If deductions are less than the sum of the investment income, capital appreciation, and contributions, then the value of the endowment will increase, and income and appreciation will continue to accumulate over time.

7.3. The Fund for the AIA is a Board-designated fund. Unless a portion of the fund is restricted by specific donor intent, it can be used for any purpose determined by AIA's Governing Board. The Executive Director and key employee(s) will recommend proposed disbursements or expenditures as needed to the Executive Committee for their approval.

8. POLICY: Administrative fee from restricted gifts

Administrative and fundraising costs ran about 22% of total expenses in FY20. In addition to these supporting services, program expenses typically exceed endowment support and incur a deficit. In October 2019, the Finance Committee approved 25%, up from 15%, from restricted gifts should be allocated to unrestricted operating income. This allocation is intended to offset administrative costs to ensure that the organization continues to run in an efficient and cost-effective manner and that its programs meet the highest levels of excellence.

8.1. Temporarily restricted gifts: 25% administrative fee will be released to operations in the fiscal year the gift is received to fulfill the program.

8.2. Restricted endowment gifts: The contribution will be deposited into the endowment fund when received per the endowment policy. 25% of the endowment draw will be allocated to unrestricted operating income in the current fiscal year.

8.3. In rare cases, the AIA Executive Director may negotiate a different administrative fee, or no administrative fee, for gifts of significant value and will notify the Governing Board or Executive Committee if this occurs.

9. Portfolio return objective

To achieve its primary objective, the total return earned by the endowment must be at least equal to the sum of the inflation rate, investment expenses, and the spending rate. The Consumer Price Index ("CPI") is the most commonly accepted measure of inflation. Thus, AIA's minimum investment return objective, expected to prevail over rolling three-to-five-year periods, would be to achieve a total net return of 5% more than the CPI.

Over the long term, equity investments have returned more than the sum of inflation and AIA's 5% target spending rate, but such long-term returns entail considerable volatility. Since AIA's objective is to enhance, where possible, the purchasing power of the endowment's assets and annual support, a real and inflation-adjusted return objective, net of spending and expenses, of 0.75% is appropriate.

Therefore, AIA's investment return objective is to achieve an expected total return, net of expenses, over a rolling three-to-five-year period of 5.75% more than the CPI.

10. POLICY: Investment asset allocation

The mix of the endowment's investments will affect the total return. It will also affect the volatility of the endowment's assets, and thus the total return and the endowment's annual support for AIA's programs. Too much emphasis on fixed income investments undercuts the objective of at least maintaining the purchasing power of the endowment. Too much emphasis on equity investments, on the other hand, undercuts the objective of reasonable stability of the endowment's annual support.

The AIA's asset allocation objectives would be comprised of acceptable asset classes, a target allocation, and an acceptable range considering the investment horizon for the AIA is indefinite; and periodic rebalancing by selling and purchasing investments to restore the mix of investments to their target proportions.

Target asset allocation and acceptable range:

65%	Equity	ranging between 55% and 75%
35%	Fixed income	ranging between 25% and 45% (including cash held for the liquidity reserve)
0%	Alternative	and no more than 10%

11. POLICY: Portfolio rebalancing

Given the size of the AIA's endowment, complicated technical methods of rebalancing are unnecessary, serving only to increase costs without corresponding benefit. Thus, AIA's rebalancing policy will be to review the mix of investments annually, as soon after the end of the fiscal year as is practical, and to rebalance to the target allocation percentage if and to the extent any asset class exceeds its acceptable range.

The Finance Committee, or a sub-committee of the Finance Committee, such as an Investment Task force or Investment sub-committee, will seek to meet quarterly or a minimum of three times per year to review the current state of the endowment, the desired asset classes, their target allocations, and acceptable ranges.

12. **POLICY: Investing endowed gifts**

Under normal circumstances, the AIA does not invest endowed gifts separately. Doing so is neither cost-effective nor would it produce a satisfactory return. Therefore, we pool the endowment funds and invest those assets collectively according to the stated investment asset allocation policy.

13. **POLICY: Contributions**

Numerous types of contributions are added to the net assets of the AIA. The three most common types of contributions are donations, grants, and endowment gifts.

13.1. Permanently restricted endowment contributions are given when donors want their gifts to generate income in perpetuity for the AIA. Donors who wish to provide perpetual support make endowment gifts to the AIA, which are added to the endowment as a permanently restricted asset. As such, the principal, or corpus, of the gift can never be spent, but the Board can invest the money. The income and capital appreciation earned from the investment become temporarily restricted assets until the AIA spends the money as specified by the donor or program.

13.2. Annual Fund contributions classified as general operating funds within the unrestricted category and are not a part of the AIA's endowment.

13.3. Grant contributions to the AIA are typically given for a specific purpose. The AIA is expected to spend all the money within one year of receipt. Hence, in many cases, the grant money appears as part of general operations and are not a part of AIA's endowment. If the grant will be expended over multiple years, the balance will be classified as temporarily restricted and released to general operations as required.

14. **POLICY: Allocation of income and expense by endowment fund**

The endowment funds are like mutual fund shares, in that they share income and investment expense in proportion to their own value. In our pooled endowment, a fund that represents 3% of the total value of our endowment would receive 3% of the investment income. The 5% endowment draw is allocated in this manner. The endowment draws release 25% for the administrative fee in addition to direct spending towards the donor's stated restriction. If the full amount is not spent, the balance is put back into the endowment as temporarily restricted funds, permitting access to those funds for spending on the stated purpose in the future while still growing the endowment.

15. **POLICY: Asset managers and custody arrangements**

If the Finance Committee deems it appropriate to utilize active managers, the following actions will be taken:

15.1. If the Finance Committee deems it appropriate to engage new asset managers either to replace an existing or manage a new appropriation, the Finance Committee will elect a subset of members to research, interview, coordinate, and present their findings to the committee.

In this case, equity and fixed income investment managers will be selected based on:

15.1.1. the discipline or style recommended from time to time by the Finance Committee (e.g., growth, value, or variations on such themes),

15.1.2. the asset manager's conformity with such discipline,

15.1.3. the asset manager's record of performance and risk incurred, and

15.1.4. the costs incurred by and on behalf of the asset manager.

15.2. Custody and other administrative arrangements will be reviewed annually.

16. **POLICY: Independent financial audit**

When the independent auditors conduct their annual review, they verify that our investments comply with the board's investment policy, the income and net appreciation and endowment draw are accurately reflected in the financial statements, and the funds were used in accordance with the donor's stated restrictions.

17. **POLICY: Five percent (5%) from new, unrestricted gifts**

To acknowledge and account for fundraising, general overhead, and administrative costs that are incurred prior to the receipt of major gifts appropriated to the Fund for the AIA, such as bequests, IRAs, estate gifts, and those received from Norton Society members, 5% from these unrestricted gifts will be recorded as contributed income in the first year the gift is received. Effective starting with the fiscal year ending June 30, 2021 (FY2021).

DEFINITIONS

Endowment

Cash donated to the AIA and subsequently invested, where the organization is required to keep the principal amount intact while using the investment income for the donor's intended purpose.

Unrestricted Funds

Cash donated to the AIA that can be spent, saved, invested, and distributed at the discretion of the AIA. Donations received from bequests and other unexpected sources are appropriated to the unrestricted, board designated *Fund for the AIA* and invested with endowment funds.

Bequests

Donations received from Norton Society members' trust or estate are appropriated to the unrestricted, board designated *Fund for the AIA* and invested with endowment funds.

Compensation

Expenses including salary, wages, commission, employee benefits, and payroll taxes.

Administrative Fee to cover indirect or overhead expenses

Expenses incurred such as rent, utilities, maintenance, office supplies, processing fees, licensing fees, operating leases, insurance, promotional materials, printing, postage, and other spending.

Net Assets Without Donor Restrictions

Net assets that are not subject to donor-imposed restrictions and may be expended for any purpose in performing the primary objectives of the AIA. These net assets may be used at the discretion of the AIA's management and Board of Trustees.

Net Assets With Donor Restrictions

Net assets subject to stipulations imposed by donors and granters. Some donor restrictions are temporary in nature; those restrictions will be met by actions of the AIA or the passage of time. Other donor restrictions are perpetual in nature, whereby the donor has stipulated the funds be maintained in perpetuity.

Investment income

When we invest money, be it permanently restricted, temporarily restricted, or unrestricted, we earn investment income in the form of interest and dividends. This income increases the value of the endowment.

Capital appreciation

The value of our investments varies according to market fluctuations. We regularly buy and sell equities, resulting in realized gains and losses. If the sum of the gains is greater than the sum of the losses, the value of our endowment increases.

Realized gains and losses

If we purchase an equity and later sell it at a higher price, then we have a realized gain. Conversely, if we sell the equity at a price lower than our original purchase cost, we have a realized loss. The gain or loss is realized because we sold the equity, and the value of our investments goes up or down accordingly.

Unrealized gains and losses

Sometimes we buy equities that increase or decrease in value, but we do not sell them. If their current price is greater or less than our original purchase price, then we have an unrealized gain or loss, and the total value of our net assets goes up or down accordingly. The gain or loss is "unrealized" because the value of the investment will continue to fluctuate if we own and hold that equity.

Annual Fund donations

Classified as general operating funds within the unrestricted category of net assets because the AIA will spend the cash according to the board-approved budget during the year in which they are received.

Grant contribution

Grants are typically made by foundations, corporations, or individuals. They are given for a specific purpose and the AIA is usually expected to spend all the money within one year of receipt. Hence, in many cases, the grant money appears as part of general operations. It is possible that the grant might be a multiyear one. In this case, and especially because the grant is given for a specific purpose, the grant balance will be classified as temporarily restricted net assets and are released to general operations as required. The AIA retains grant funds only as long as it takes to spend all of the money and fulfill the donor's intentions.