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13.2% Investment Return for 2017

Is Highest for Healthcare Organizations Since 2013

Organizations Participating in Commonfund Benchmarks Study® of Nonprofit Healthcare Organizations Report Mixed Long-Term Results

NEW YORK, NY, September 11, 2018—The 56 nonprofit healthcare organizations participating in the 2016-2017 Commonfund Benchmarks Study® *Healthcare Organizations Report* reported a return on investable assets of 13.2 percent for 2017, the highest return since 13.3 percent reported for 2013. For 2016, which was also included in the Study, participating organizations' return on investable assets was 6.2 percent.

Returns for both 2016 and 2017 were higher than those reported by healthcare organizations participating in the previous Study, conducted for 2014 and 2015. Returns for those years were 4.4 percent for 2014 and -1.6 percent for 2015.
All returns in the Study are reported net of fees. Study data address the 2016 and 2017 calendar years, which coincide with participating organizations' fiscal years (beginning January 1 and ending December 31). "Investable assets" include endowment/foundation funds, funded depreciation, working capital and other separately treated assets.

The double-digit gains reported for 2017 benefited healthcare organizations by improving mission-critical long-term results. For the trailing three-, five- and 10-year periods, reported average annual returns on investable assets were 5.9 percent, 6.9 percent and 4.6 percent, respectively, for 2017. For 2016, comparable returns were lower, at 3.1 percent, 6.5 percent and 4.2 percent, respectively.

"In a challenging environment, healthcare organizations and systems that can make strategic financial commitments to infrastructure, technology and expanded provider networks should be able to prevail. The investable asset pool is a key resource in this regard, and Commonfund is pleased to see the strong return registered for 2017," said Cathleen Rittereiser, Executive Director of Commonfund Institute, which conducted the Study. "The concern, however, is a shortfall in long-term returns. Healthcare organizations confront a difficult balancing act: maintaining a large enough allocation to fixed income investments to satisfy bond rating agencies' emphasis on balance sheet liquidity but not so large that these low-yielding fixed income investments weaken the portfolio's ability to grow and meet future needs," Ms. Rittereiser continued.

In the critical area of asset allocation, participating organizations reported only modest year-over-year differences, as reflected in the following table:

Investable Asset Pool Asset Allocation 2016-2017

Percent

	2016	2017
U.S. equities	19	21
Fixed income	31	31
Non-U.S. equities	19	20
Alternative strategies	26	25
Short-term securities/cash/other	5	3

Measured against the last Study for 2014-2015, asset allocation among participating organizations showed somewhat greater changes. Compared to 2015, the greatest changes in investable assets in 2017 were an increase in the allocation to fixed income to 31 percent from 28 percent and a decrease in the allocation to alternative strategies to 25 percent from 29 percent. (Alternative strategies include private equity, marketable alternative strategies, venture capital, private equity real estate, energy and natural resources, commodities and managed futures, and distressed debt.)

Looking at longer-term trends, the greatest shifts in asset allocation over the past five years occurred in fixed income and alternative strategies. Ms. Rittereiser observed that, "The allocation to fixed income reached a low of 25 percent in 2013 but rose to 31 percent in 2017, while the allocation to alternative strategies went the opposite way and declined by an equal six percentage points, to 25 percent from 31 percent. In a low interest rate environment, the large fixed income allocation may weigh on overall portfolio return."

The 56 organizations participating in the Study reported an average investable asset pool of $2.1 billion as of December 31, 2017, and median investable assets of $987.0 million as of the same date. For the 32 organizations reporting defined benefit (DB) plan market value, the average plan value was $2.0 billion as of year-end 2017, while the median market value as of the same date was $481.0 million. The Study separates data from the 56 participants into three size cohorts: organizations with investable assets over $1 billion; those with investable assets between $501 million and $1 billion; and those with investable assets under $501 million.

DB Plan Assets Return 14.9% in 2017

Compared to the return on investable assets, participating organizations realized slightly better 2016-2017 returns on their DB plan assets, with returns averaging 7.2 percent for 2016 and 14.9 percent for 2017. For 2016, DB plan returns for the trailing three-, five- and 10-year periods averaged 3.9 percent, 7.3 percent and 4.8 percent, respectively. For

2017, DB plan returns for the same periods averaged 6.6 percent, 7.8 percent and 5.4 percent, respectively. The following table reflects year-over-year changes in DB plan asset allocation:

DB Plan Asset Allocation 2016-2017

Percent

	2016	2017
U.S. equities	22	20
Fixed income	31	32
Non-U.S. equities	22	24
Alternative strategies	24	23
Short-term securities/cash/other	1	1

Like the investable asset pools, changes in DB plan asset allocation over the two-year period were *de minimis.* DB plan asset allocations reflected greater changes from 2015 to 2017, however. Resembling those changes occurring in investable asset pools, the DB plan allocation to fixed income increased to 32 percent from 28 percent while the allocation to alternative strategies declined to 23 percent from 28 percent. In addition, DB plans showed movement in two areas that were little changed for investable assets: The DB plan allocation to non-U.S. equities grew to 24 percent in 2017 from 20 percent in 2013 and the allocation to short-term securities/cash/other declined to 1 percent from 5 percent over the same period.

Other highlights to be found in the Study include the following:

Investment Return Budgeting, Long-Term Return Objectives and Operating Margin

Participating healthcare organizations budgeted an investment return of 5.1 percent for 2016 and 5.0 percent for 2017. This compares to a budgeted investment return of 4.9 percent for both 2014 and 2015 in the previous Study.

Examining long-term investment objectives for their operating assets, participating organizations' 2017 target was 6.0 percent, up from 5.8 percent in 2015. Twenty-one percent of Study respondents said they do not have a return objective (an additional 13 percent were uncertain of their return objective). The median operating margin for 2017 was 3.5 percent.

Debt

The average debt-to-capitalization ratio for participating organizations was 29.3 percent for 2017 compared to 26.5 percent for 2015 in the previous Study. Twenty-five percent of Study participants reported increasing their debt-to-capitalization ratio in 2017 versus 57 percent that decreased it. Five percent reported no change.

Thirty-seven percent of Study participants reported having the highest or high investment-grade rating for their bonds; 55 percent reported other investment-grade ratings; no organization (0 percent) reported non-investment-grade ratings; and 8 percent gave no answer or were uncertain.

Seventy-one percent of debt was fixed rate, while 29 percent was variable in 2017.

Resources, Management and Governance

Participating healthcare organizations reported employing an average of 2.1 full-time equivalent (FTE) professionals to manage the investment function in 2017, little changed from 2.0 FTEs in 2015. The median figure was 1.8 FTEs, twice that of 0.9 FTE reported in 2015.

Participating healthcare organizations reported using an average of 4.4 investment managers each to oversee their U.S. equity allocation in 2017, and an average of 4.5 managers to run their fixed income and non-U.S. equity allocations. They retained an average of 16.0 managers for their alternative strategies (direct) allocation and an average of 2.6 managers for their alternative strategies (fund of funds) allocation.

Twenty-seven percent of all participants said they had substantially outsourced their investment function in 2017, down two percentage points compared to 2015.

Ninety-one percent of participants said they used a consultant in 2017, up from 85 percent in 2015. Asset allocation/rebalancing, manager selection, performance attribution and management, and ongoing due diligence were cited as the most frequently used consultant services.

The average number of voting members on investment committees stood at 7.9 for 2017, up slightly from 2015's average of 7.4. An average of 4.3 committee members were investment professionals; an average of 2.7 members had alternative strategies experience; and an average of 2.5 were non-trustee voting members.

Research Process and Methodology

The design of the 2016-2017 Commonfund Benchmarks Study took place in the winter of 2016-2017. Data-gathering took place in the first and second quarters of calendar 2018 using an online survey instrument. Our sample universe targeted senior staff at healthcare organizations with investable assets of $100 million and more. Respondents were supported by online documentation and a dedicated help desk.

About Commonfund

Commonfund was founded in 1971 as an independent asset management firm focused on not-for-profit institutions. Today, we are one of North America's leading investment firms, managing $25 billion in assets for some 1,400 institutional clients, including educational endowments, foundations and philanthropic organizations, hospitals and healthcare organizations and pension plans. Our primary business is investment management, and we are active in all sectors of the global capital markets, both public and private.

About Commonfund Institute

Commonfund Institute houses the education and research activities of Commonfund and provides the entire community of long-term investors with investment information and professional development programs. Commonfund Institute is dedicated to the advancement of investment knowledge and the promotion of best practices in financial management. In addition to producing the Commonfund Benchmarks Study® *Healthcare Organizations Report,* Commonfund Institute teams with the Council on Foundations to produce the Council on Foundations-Commonfund Study of Investment of Endowments for Private and Community Foundations® (CCSF), as well as the Commonfund Benchmarks Study® series of research reports. Commonfund Institute also provides a wide variety of resources, including conferences, seminars and roundtables on topics such as endowments and governance; proprietary and third-party research and publications, including the Commonfund Higher Education Price Index® (HEPI); and events such as the Commonfund Institute® and the annual Commonfund Forum.

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