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Nonprofit Healthcare Organizations Report

Flat Investment Returns for FY2011

Participants in Commonfund Benchmarks Study® See

A Year of Zero Investment Return after Two Years of Double-Digit Gains

WILTON, CT., September 4, 2012 –The 86 nonprofit healthcare organizations participating in the 2012 Commonfund Benchmarks Study® of Healthcare Organizations reported investment returns of zero in FY2011. The flat returns followed net gains of 10.9 percent in FY2010 and 18.8 percent in FY2009.

For the trailing three years, these organizations' average annual net return on investable assets was 9.6 percent, while for the trailing five years annual net returns averaged 1.8 percent. The three-year period included the strong 2009 and 2010 returns, while the five-year return reflects the -21.2 percent return registered in 2008 when the financial crisis was most severe. ("Investable assets" include endowment/foundation funds, funded depreciation, working capital and other separately treated assets.)

Participating organizations realized somewhat better FY2011 net returns on their

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defined benefit (DB) plan assets, averaging 1.3 percent. This figure, too, was significantly lower than the FY2010 net return, which averaged 12.3 percent. Three-year DB plan returns averaged 11.0 percent while five-year returns averaged 2.2 percent.

The 2012 Study addressed investment and governance practices and policies for the 86 participating healthcare organizations over the 2011 fiscal year (January 1 – December 31, 2011). Participating organizations represented \$99.8 billion in investable assets and \$42.4 billion in DB plan assets as of December 31, 2011. The Commonfund Benchmarks Study® *Healthcare Report* has been published annually since 2003 by Commonfund Institute.

Beyond the flat year-over-year return, the most important shift to emerge from the Study was in asset allocation, where healthcare organizations' allocation to alternative investment strategies in their investable asset pools grew to an average of 21 percent in FY2011 from 17 percent in FY2010. This increase in the allocation to alternatives appears to have been funded by a decreased allocation to domestic equities, which declined to 20 percent in FY2011 from 24 percent in FY2010.

"Healthcare organizations' higher allocation to alternatives is an ongoing trend that mirrors what we have found in recent annual studies of colleges and universities, foundations, and operating charities," said John S. Griswold, Executive Director of Commonfund Institute. "Healthcare organizations' allocations to alternative strategies, in the range of 20 percent (dollar weighted), are far lower than the 53 percent average allocation reported in the most recent study of colleges and universities. But we believe that the longer-term significance of this trend is greater adoption by healthcare

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organizations of the ‘endowment model,’ whose major tenets are the pursuit of total return through asset class diversification, the acceptance of lower portfolio liquidity and a long-term time horizon.”

Griswold pointed to fixed income allocations as another area of significant difference between healthcare organizations and other types of nonprofit. While healthcare organizations reported an average fixed income allocation of 36 percent in FY2011, allocations to this asset class were much lower, ranging from a low of 10 percent among colleges and universities to a high of 22 percent among operating charities. Healthcare organizations’ higher fixed income allocations have historically been used to support credit facilities and bond ratings for these capital-intensive institutions.

Viewing FY2011 returns by asset class, fixed income provided the highest return, an average of 5.4 percent. This was followed by a 3.9 percent return for alternative strategies, 0.2 percent for short-term securities/cash, -0.2 percent for domestic equities and -10.9 percent for international equities.

Within the alternative strategies category, the highest returns came from private equity real estate, which advanced 14.1 percent; venture capital, which gained 11.1 percent; and private equity, which returned 10.7 percent. Marketable alternatives, which represent the largest single alternatives allocation for many healthcare organizations, returned -1.8 percent. (Marketable alternatives include hedge funds, absolute return, market neutral, long/short 130/30, event-driven and derivatives.)

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The Study separates data from the 86 participants into four size cohorts: institutions with investable assets over \$1 billion; those with investable assets between \$501 million and \$1 billion; those with assets between \$251 and \$500 million; and those with investable assets below \$251 million. For FY2011, investment returns were correlated to size; the larger the organization, the better the return. Organizations with investable assets over \$1 billion realized an average return of 0.6 percent while the smaller organizations at the opposite end of the size spectrum lagged with a return of -1.9 percent. For DB plan assets, organizations with assets over \$1 billion also had the best 2011, an average return of 2.3 percent. This was well ahead of 0.6 percent for organizations with assets between \$501 million and \$1 billion.

Other major findings of the 2012 Commonfund Benchmarks Study of Healthcare Organizations are highlighted below.

Asset Allocation

At December 31, 2011, participating healthcare organizations' asset allocations were:

<u>Asset Class</u>	<u>Investable Assets</u>	<u>DB Plan Assets</u>
<u>Numbers in percent (%)</u>		
Domestic equities	20	24
Fixed income	36	33
International equities	15	20
Alternative strategies	21	20
Short-term securities/cash/other	8	3

2012 Commonfund Benchmarks Study® of Healthcare Organizations...Add Four

Seventy-nine percent of Study participants reported rebalancing their portfolio in FY2011.

Budgets, Operating Margins and Investment Income

Among Study participants, operating budgets in FY2011 averaged \$1.52 billion, a 31 percent increase over last year's \$1.16 billion and a 61 percent increase over FY2009's average of \$946 million. Overall operating margins were unchanged at 4.1 percent, and ranged from a high of 4.9 percent among organizations with assets over \$1 billion to a low of 3.6 percent among organizations with assets between \$251 and \$500 million.

Participating organizations' capital budgets contracted significantly in 2011, falling to an average of \$99.9 million from \$143.0 million in FY2010—perhaps indicating a slowing in expenditure after years of heavy investment in medical and information technology. While organizations with assets over \$1 billion averaged \$173.3 million in capital spending in FY2011, organizations with assets under \$251 million spent an average of just \$8.2 million, a level that may not enable them to remain competitive.

Debt

After rising for six consecutive years, debt declined for participating healthcare organizations, as they reported average debt of \$723 million versus \$1.0 billion in last year's Study. Debt fell most dramatically for organizations with assets over \$1 billion, declining to an average of \$1.3 billion from \$2.1 billion in FY2010. Forty-nine percent of

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participating healthcare organizations reported decreasing debt, while 26 percent reported an increase and 25 percent reported no change.

Resources, Management and Governance

Participating healthcare organizations reported employing an average of 1.6 full-time equivalent (FTE) professionals to manage the investment function. This compares with an average of 1.5 FTEs reported in last year's Study.

The average number of voting members on investment committees declined slightly to 8.0 from 8.1 in last year's Study. The number of investment committee members who are investment professionals rose, climbing to an average of 4.1 from 4.0 in FY2010. The average number of investment committee members with experience in alternative strategies declined modestly, to 2.2 from 2.3 in FY2010.

Participating organizations reported using an average of 25.4 investment management firms in FY2011 compared with an average of 21.7 managers in FY2010. By a wide margin, organizations with assets over \$1 billion used the most managers, an average of 38.8.

Research Process and Methodology

The design of the Commonfund Benchmarks Studies of Healthcare Organizations took place in the winter of 2011. Field interviews with the participating institutions followed in the first and second calendar quarters of 2012.

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Data from the overall Study population of healthcare organizations were segmented into four size categories to permit analysis of the policies and practices of organizations of differing sizes.

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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 the Commonfund Benchmarks Studies, Commonfund Institute teams with the National Association of College and University Business Officers (NACUBO) to produce the NACUBO-Commonfund Study of Endowments (NCSE) and provides a wide variety of resources, including conferences, seminars and roundtables on topics such as endowments and treasury management; proprietary and third-party research and publications, including the Higher Education Price Index (HEPI); and events such as the annual Commonfund Forum and Commonfund Endowment Institute.

About Commonfund

Founded in 1971, Commonfund is an institutional investment firm serving nonprofit institutions, pension funds and other leading institutional investors offering a broad range of investment solutions in traditional and alternative strategies. Directly or through its subsidiaries—Commonfund Capital and Commonfund Asset Management Company—Commonfund manages \$26 billion for 1,500 clients. Commonfund, together with its subsidiary companion organizations, offers more than 30 different investment programs. All securities are distributed through Commonfund Securities, Inc., a member of FINRA. For additional information about Commonfund, please visit www.commonfund.org