Managing an Integrated Balance Sheet

One of the challenges organizations face is managing their balance sheet in a more integrated way. For years, Boards and CFOs have received advice from partners in isolated silos: investment managers focus on the investment portfolio; debt consultants think about debt capacity; development officers care about fundraising. However, each of these financial elements is inter-related, and today's environment of low returns and heightened fiduciary scrutiny makes decision making even more complex. How can an organization link all its financial inputs together rather than considering each individually?

Analyzing the information to support this broader thinking is a daunting task. As stewards of non-profit institutions, Boards of Trustees and senior leaders must consider the impact of all their financial decisions on the organization's resources and balance sheet. Gathering information and evaluating complex scenarios puts added stress and time commitments on the volunteers and staff charged with the fiduciary responsibility to manage institutional assets.

Investment offices play an important role in this process and must apply a broader perspective and contribute to more comprehensive solutions. All financial resources and constraints need to be considered when determining appropriate investment policies to advance the mission and achieve objectives.

The ability to advance the mission through integrated balance sheet management includes not only expert investment management, but also a sound understanding of other organizational components – revenues, debt, gifts, and other considerations – to properly manage the complex nature of an institution's financial health.

King Pine Investments' principals have collaborated on in-depth projects that highlight the complexity and importance of integrated balance sheet management. Two case studies follow:

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Case Study 1:
Accelerating the Strategic Plan through Balance Sheet Management

With interest rates so low, the University Board of Trustees wanted to evaluate the ability of the University to issue more debt in order to accelerate projects in the Strategic Plan. The discussions that ensued raised many complex questions regarding increasing debt and the impact on the University's financial statements.

- What was the debt capacity of the University based on current finances? What would be the impact of additional debt on its credit rating and future access to debt markets?
- How should a capital campaign benefit the University's Strategic Plan versus growing the Endowment?

The OCIO and staff designed several hypothetical stress scenarios to analyze the individual and collective impacts on:

- Debt capacity and current bond covenants
- Endowment spending
- Annual giving
- Enrollment
- Illiquidity of the Endowment
- New scholarships vs current scholarships

The stress tests are updated annually and evaluated at the annual review of the University's investment policy.

Case Study 2:
Understanding the Likelihood of Financial Stress

The College Board of Trustees was considering special draws from its Endowment to fund major new programs. However, they struggled to understand the impact of the decision on the College's overall financial resources. The College actively uses debt as part of its capital structure. Bond covenants stipulate a minimum level of liquidity for the Endowment. In addition, the College is a long-time investor in illiquid investments, maintaining a significant allocation to long-term, illiquid investments of 25 percent of the total portfolio. The additional spending draws from the Endowment would significantly reduce the liquidity buffer held for the bond covenant.

The OCIO and staff recognized that they needed to provide the Board with an analysis highlighting the impact of various market scenarios on the bond covenants if the increased draws were taken. An analysis was developed that projected the probability of breaching the debt covenants on the two semi-annual measurement dates. The analysis is currently used to guide investment recommendations and, potentially, the timing of spending draws. More importantly, the collaboration between the OCIO and senior staff provides the Board better insight into the College's financial risks.

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