Private Capital Reporting and Investing for Nonprofits

The webinar will begin in a few moments

NOTE: Participants will receive an email within 48 hours with a link to the slide deck and recording.

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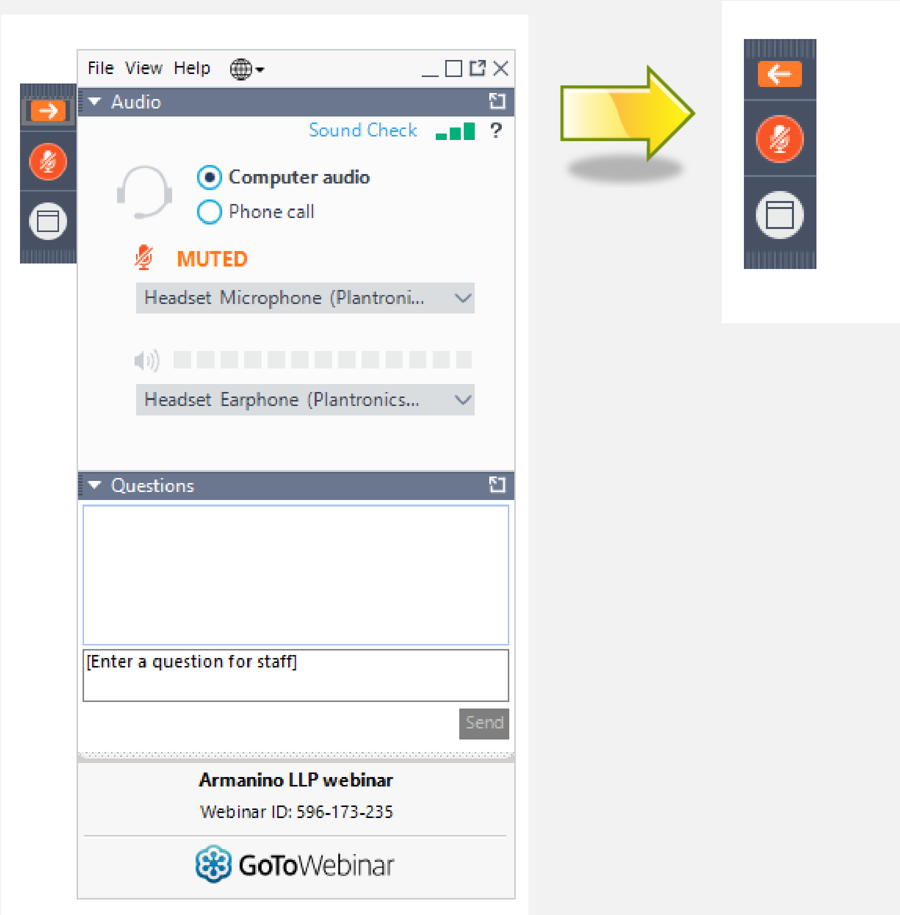

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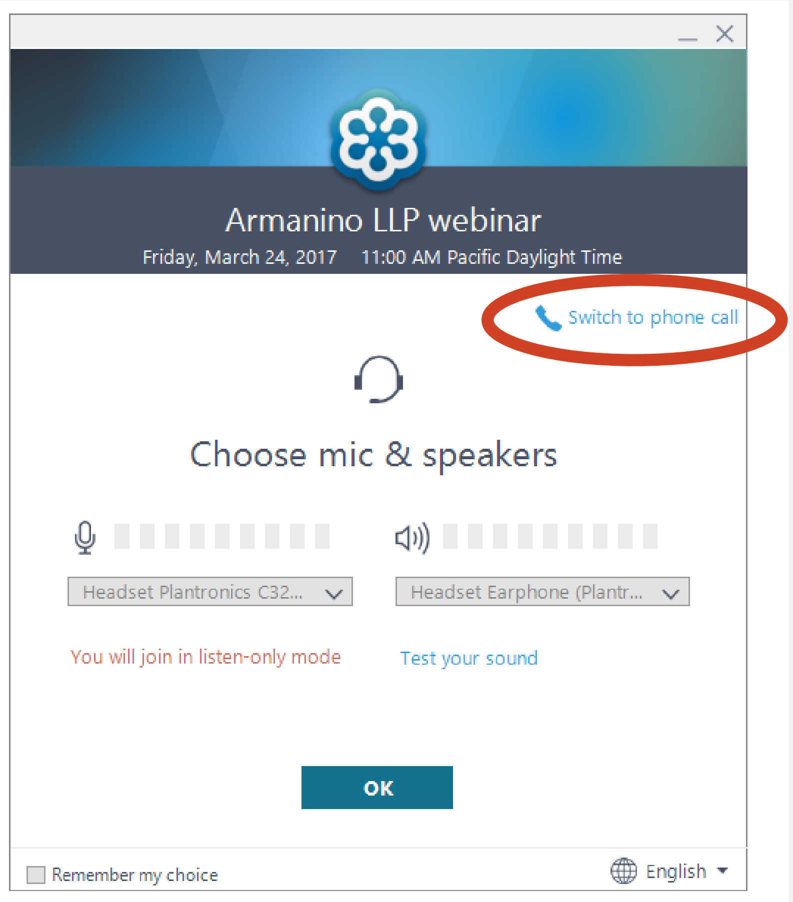

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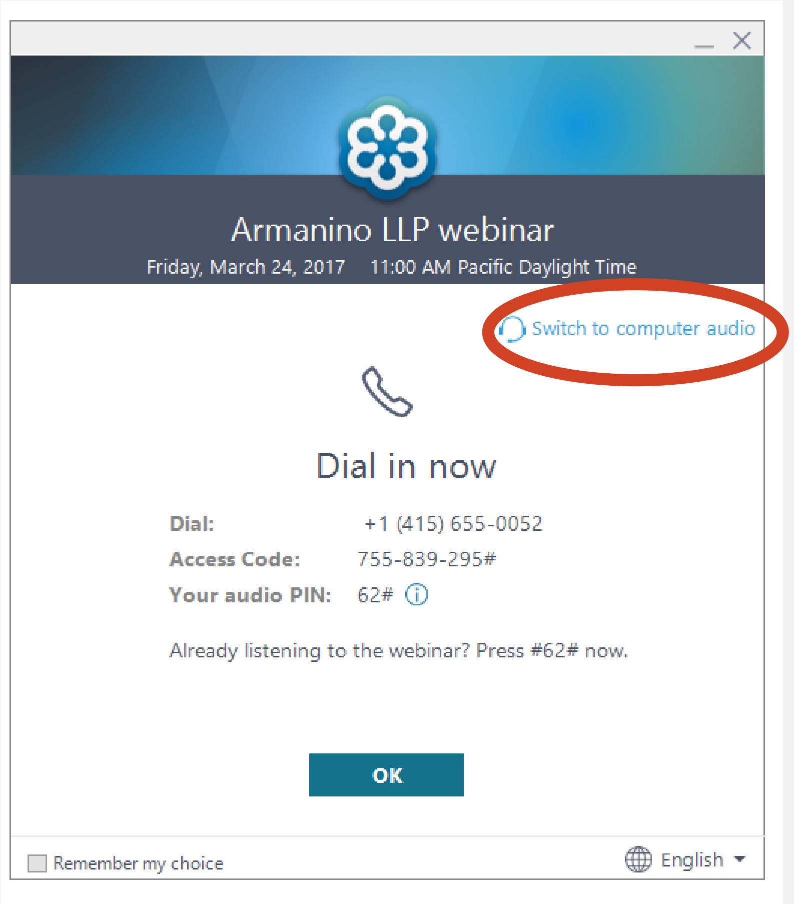

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To qualify for CPE, you must:

- Use a personal computer (no smartphones) and log in with your own information and unique URL
- Be logged into our online software for at least 50 consecutive minutes within the scheduled time frame of the webinar
- Actively respond to at least 75% of the polling questions
- Complete evaluation survey at the end of the webinar

Based on the Board of Accountancy Requirements, Armanino is not a NASBA certified provider

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Learning Objectives

- Describe characteristics of private capital
- Discuss accounting best practices nonprofits can consider when holding private capital investments
- Analyze a paced approach to gain vintage year and strategy diversification

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Today's Presenters

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Polling Question #1

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Introduction to Private Capital

Presented By:

Jason Levey, CAIA, Director, Canterbury Consulting

February 5, 2019

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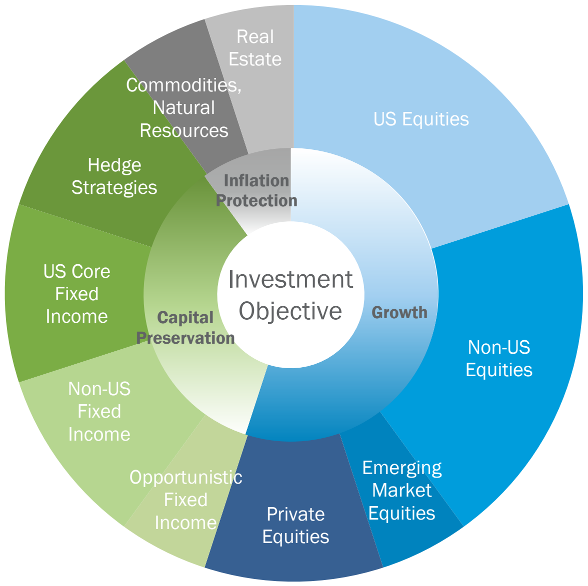
Why Consider Private Capital?

Role of Asset Class

We look beyond the capital market assumptions to the role that each sub style plays as well as the associated risks



Role	Asset Categories	Risk
Growth	Public and Private Equity	Market Decline
Capital Preservation	Fixed Income, Hedge Funds	Rising Interest Rates, Highly Correlated Markets
Inflation Protection	Real Assets: Real Estate, Commodities	Deflation

Growth

- Asset classes that are expected to drive long term growth

Capital Preservation

- Asset classes that mitigate overall portfolio volatility

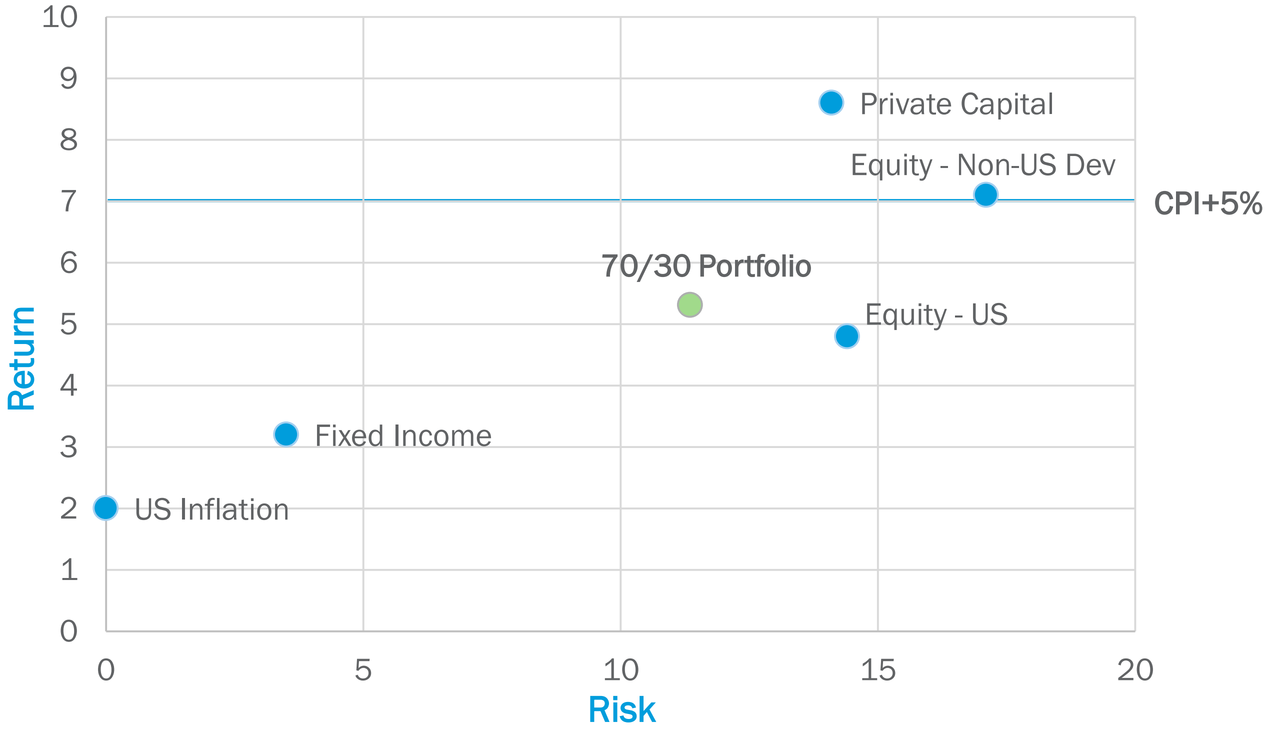
Inflation Protection

- Segment of the portfolio that is sensitive to inflation and will benefit from a rising rate of inflation

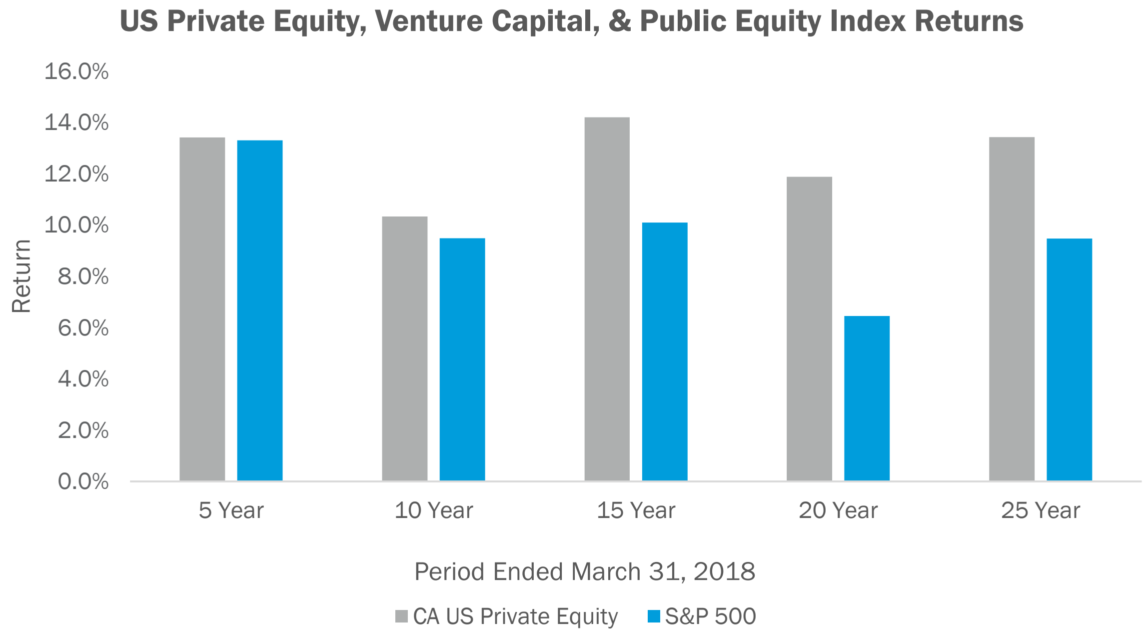
Why Include Private Capital in a Portfolio?

Merits

— Long-term outperformance over public markets
— Focus on an inefficient market, with the opportunity to drive returns through operational value-add, use of leverage, and multiple arbitrage
— Lower correlation with traditional asset classes as well as other asset classes within alternative investments
— Access to developing industries and technologies



Consistent Outperformance vs. Public Markets

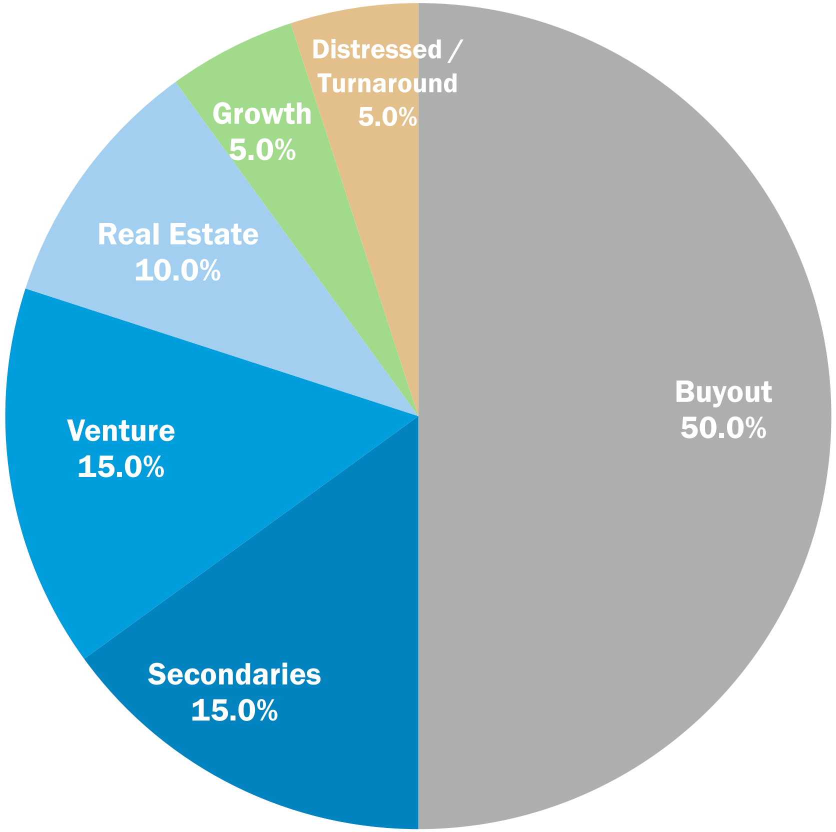


Source: Cambridge Associates, Frank Russell Company, and S&P. Data as of March 31, 2018.

- Private equity has consistently outperformed the S&P 500 over the long-term (i.e., 10 years or more)
- In a low growth, low return environment, private capital will play a crucial role in helping the portfolio to meet its long-term performance objectives
- While decisions aren't based entirely on past performance, past performance in private capital has shown the ability to be more persistent than in public markets

Building a Private Capital Program

Construction - Allocation



Buyout

- Acquisition of a controlling interest in companies, often utilizing leverage in the transactions

Secondaries

- Primarily purchasing existing investor commitments to private equity funds, generally at a discount

Venture Capital

- Focus on startups and early-stage companies with long-term, high-growth potential

Real Estate

- Includes the development, acquisition, financing, and ownership of real estate properties

Growth

- Usually a minority investment in relatively mature companies seeking capital to expand or restructure operations

Distressed/Turnaround

- Targeting companies experiencing distress such as liquidity, capitalization, and/or underperformance issues

Performance by Vintage Year

2015	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005
36.3 Secondaries	20.3 Secondaries	17.6 Venture	18.5 Secondaries	19.6 Secondaries	17.1 Growth	17.4 US PE Index	14.1 Distressed	13.4 Growth	11.0 US PE Index	27.7 Growth
17.6 Growth	17.1 US PE Index	16.8 Buyout	18.0 Buyout	19.6 Venture	16.7 US PE Index	16.2 Buyout	13.3 Buyout	11.8 Buyout	9.6 Buyout	10 Buyout
15.2 Buyout	16.0 Buyout	15.2 Secondaries	15.4 Growth	18.3 Real Estate	16.0 Real Estate	12.9 Secondaries	13.0 US PE Index	11.1 US PE Index	9.5 Growth	7.6 US PE Index
15.0 Distressed	14.9 Growth	14.4 US PE Index	15.2 Real Estate	15.2 Buyout	14.5 Secondaries	12.8 Real Estate	12.7 Secondaries	10.5 Secondaries	5.2 Distressed	6.4 Secondaries
12.7 Venture	14.1 Venture	13.1 Real Estate	14.5 US PE Index	14.0 US PE Index	13.9 Venture	10.7 Distressed	9.1 Real Estate	9.2 Venture	5.2 Secondaries	3.9 Distressed
11.5 Real Estate	13.0 Real Estate	12.0 Growth	13.7 Venture	12 Growth	13.8 Buyout	10.5 Venture	7.7 Growth	7.6 Distressed	4.2 Venture	3.5 Venture
11.2 US PE Index	11.2 Distressed	8.8 Distressed	10.6 Distressed	9.2 Distressed	12.7 Distressed	N/A Growth	3.7 Venture	6.6 Real Estate	3.2 Real Estate	2.1 Real Estate

Source: Preqin

Private Capital Pacing Model

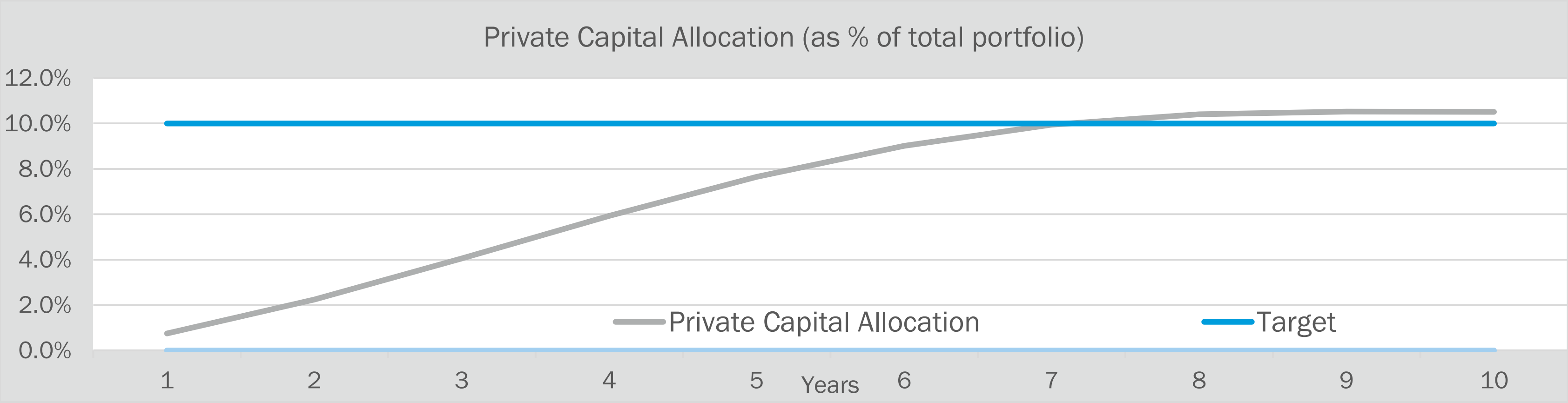
Total Portfolio Value: $100,000,000

Private Equity Target Allocation: 10%

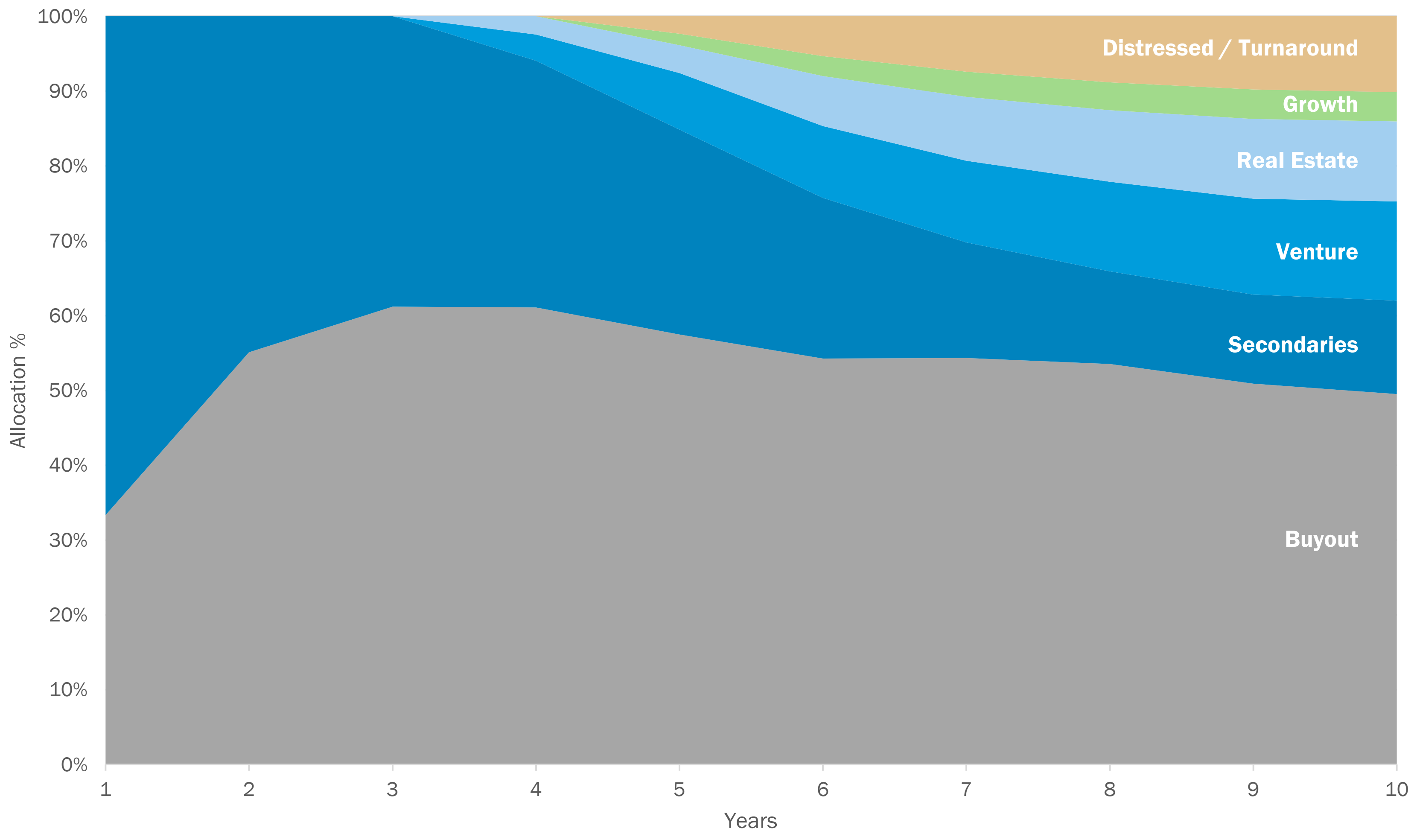
Assumed Portfolio Growth Rate: 5.3%

Assumed Portfolio Spend Down: 4.0%

	Year	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Total	Commitment	$3,000,000	$3,000,000	$2,000,000	$2,000,000	$2,000,000	$2,000,000
	Contribution	$750,000	$1,492,500	$1,775,150	$1,890,281	$1,917,952	$1,914,753
	Distribution	$0	$11,779	$75,434	$246,297	$564,703	$1,042,273
	Net Cash Flow	$750,000	$1,480,721	$1,699,716	$1,643,984	$1,353,249	$872,480
	Valuation	$750,000	$2,296,346	$4,193,243	$6,195,375	$8,072,845	$9,618,760



Private Capital Pacing Model



Challenges and Risks

Considerations

Private Capital Considerations

— Investments are illiquid, with a 10+ year lockup
  - Level three assets

— Additional management of ongoing capital calls and distributions

— Limited control over strategy execution and fund deployment

— Fees, including annual asset-based fees of ~2% in addition to carried interest (20%+ of profits)

— Dispersion of returns, which underscores the importance of manager selection

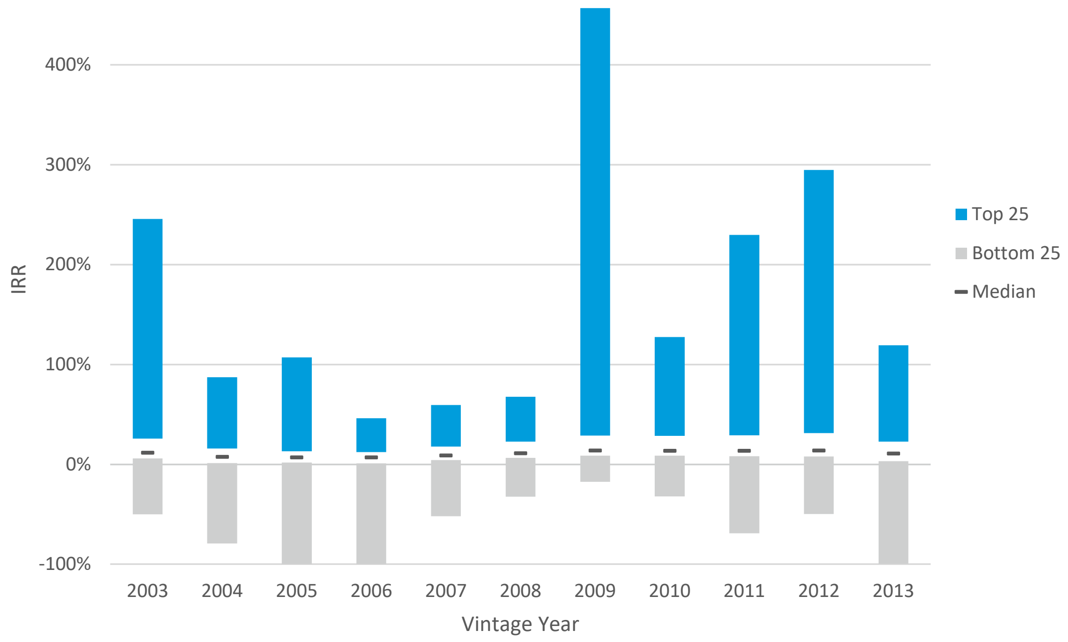
— Use of leverage

Manager	Vintage Year	Commitment	Cumulative Takedown	Cumulative Distributions	Portfolio Value	Unfunded Commitment	IRR
Strategic Partners IV	2008	$2,500,000	$2,459,653.00	$3,282,075.00	$491,965	$40,347.00	12.55
Montauk Triguard V	2011	$2,000,000	$1,440,000.00	$1,082,020.00	$697,224	$560,000.00	9.39
Siguler Guff BRIC III	2011	$2,000,000	$1,785,000.00	$1,497,588.00	$1,366,519	$215,000.00	14.97
Oak Hill Advisors European Strategic Credit	2011	$2,000,000	$1,480,046.00	$1,294,326.00	$566,327	$519,954.00	7.21
AG Realty Fund VIII	2012	$2,000,000	$2,000,000.00	$1,879,734.00	$1,094,823	$0.00	14.42
Rialto Real Estate II	2013	$1,500,000	$1,500,000.00	$748,582.00	$1,150,942	$0.00	8.71
New Mountain IV	2014	$2,000,000	$1,775,851.00	$290,362.00	$1,989,204	$224,149.00	18
Vista Equity VI	2016	$2,000,000	$1,462,723.00	$13,333.00	$1,450,905	$537,277.00	-2.98
Total Account		**$16,000,000**	**$13,903,273**	**$10,088,020**	**$8,807,909**	**$2,096,727.00**	**11.92**

Importance of Manager Selection

— A wide dispersion of returns between top and bottom quartile funds is an important consideration in private capital

— As such, manager selection is essential to achieving outperformance in a private capital portfolio



Source: Preqin 2016 (all funds; all geographic focuses)

Canterbury's Private Capital Program

- 21 years experience investing in private capital
- Expected to allocate between $175 M and $225 M to private capital in 2019
- Approximately 45.3% of clients are invested in private capital
- Range of clients by AUA that are invested in private capital
  - Smallest: $5 M
  - Largest: $1.8 B

Polling Question #2

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Accounting Best Practices

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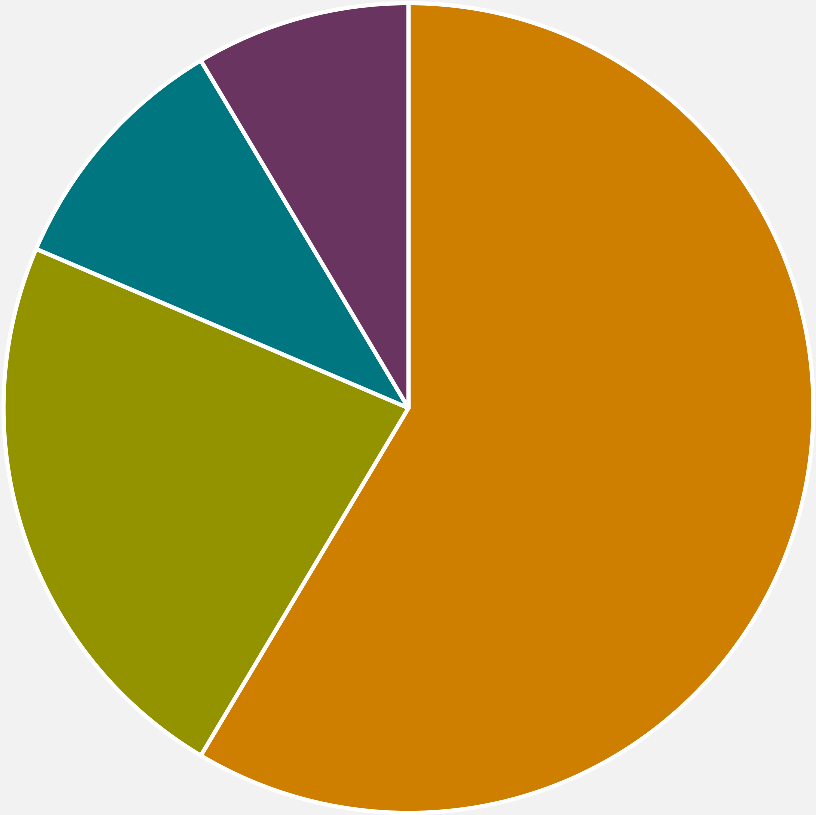
Growing complexity



Private capital and other alternative investments have gained in popularity and increased nonprofit returns, benefiting:

- Operating income
- Endowment growth
- Mission-oriented program flexibility
- Geographic expansion

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Considerations

- New private capital investments require careful consideration of:

  - Additional Accounting Processes
  - Unrelated Business Income Tax
  - Impact from FASB ASU 2016-14

Additional Accounting Processes

New Fund Statements

Fund Commitments

Off-Year Reporting

Year-End Valuation

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Unrelated Business Income Tax (UBTI)

- UBTI = gross income derived from an unrelated trade or business regularly carried on by an organization.

Don’t be surprised!

FASB ASU 2016-14

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Polling Question #3

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Liquidity & Availability of Resources

OBJECTIVE OF PROJECT

To improve the quality of information users have to assess liquidity and how nonprofit organizations manage their exposure to liquidity risk including limitations on the use of financial assets…

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Liquidity and Availability

Disclosure requirements

- Qualitative information on how an NFP manages its liquid available resources and its liquidity risk
  - In the notes
- Quantitative information that communicates the availability of financial assets at the date of the Statement of Financial Position to meet cash needs for general expenditures within one year.
  - On the face of the Statement of Financial Position and/or in the notes

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What is considered unavailable?

NATURE OF FINANCIAL ASSET	Financial assets that **CANNOT** be converted to cash	▪ Accounts and notes receivables due in > 1 year ▪ Contributions receivable due in > 1 year ▪ Investments not redeemable within 1 year
EXTERNAL LIMITS OF DONORS, LAWS, CONTRACTS	Donor restrictions limiting availability	▪ Endowment assets considered perpetually restricted ▪ Assets from unappropriated endowment earnings, beyond 1 year ▪ Restricted for programs in future years, beyond 1 year ▪ Trust and life income funds
	Contractual and legal restrictions	▪ Assets set aside from Debt service or Bond sinking fund agreements ▪ State required annuity reserves and assets set aside under self-insurance agreements
INTERNAL LIMITS IMPOSED BY GOVERNING BOARD	Financial assets designated for long-term investments	▪ Long-term quasi endowments
	Designated for future years	▪ Designations for future periods beyond a year

Quantitative Availability Disclosure Analysis

		6/30/2019
Financial assets		
Cash and cash equivalents	$	5,800,000
Contributions receivable		5,000,000
Investments		45,000,000
Perpetual trusts held by others		400,000
Total financial assets		*56,200,000*
Less: amounts unavailable for		
general expenditure within one year:		
Long-term contributions receivable		(2,500,000)
Investments not redeemable		(25,000,000)
Board-designated investments		(6,000,000)
Endowment investments		(3,000,000)
Financial assets available to meet cash needs for general expenditures within one year	*$*	*19,700,000*

Qualitative Liquidity Disclosure

Liquidity (Qualitative) Best Practices

- How does the nonprofit manage daily cash requirements?
- Are there liquidity reserves already established?
- Are there board-designated funds that could be used if needed?
- Are there lines of credit available?
- Do private equity investments have redemption restrictions or other lock-up requirements?

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Polling Question #4

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