NATIONAL CENTER FOR
FAMILY PHILANTHROPY

Family Giving Online Knowledge Center
Board Activities

TITLE: **Reducing Investment Costs**

SOURCE: ***Investment Issues for Family Funds***

REDUCING INVESTMENT COSTS

By reducing costs, a foundation board may be able to adopt a more conservative portfolio and still achieve the returns needed to maintain or increase purchasing power. Many smaller foundations look to an indexed approach to attain the excellent returns historically associated with equity markets, without the drag of investment costs. Three common methods for developing a portfolio with limited investment costs are mutual funds, separate accounts, and self-implementation:

- ***Mutual Funds.*** Mutual funds are the vehicle of choice for many smaller foundations. Advantages include ease of implementation, moderate costs, low thresholds for investment, and a huge selection of alternatives. On the downside, mutual funds must maintain a cash reserve to meet redemptions, and returns are diminished accordingly. In addition, costs tend to be somewhat higher than either separate account management or self-implementation. Finally, because contributions tend to pour into the funds during market highs and to be withdrawn during market lows, investors in mutual funds are often forced into a "buy high/sell low" scenario by the managers. On the whole, however, mutual funds are an excellent choice for investing the endowments for smaller foundations.

- ***Separate Account Managers.*** Many foundations hire advisors to manage separate accounts on their behalf. Advantages include the potential for lower costs and negotiated fees; direct input to and feedback from the manager; and the potential for developing a customized portfolio. This type of investing is appropriate for foundations interested in socially responsible investing or in developing other individualized approaches. Many of the better investment managers do, however, have investment minimums ranging from several million to tens of millions of dollars. Thus, smaller foundations may be precluded from employing separate account managers. Moreover, even for those for smaller foundations that are able to meet one manager's established minimum, diversification may be limited because the foundation endowment is not sufficient to meet the minimum for multiple managers with their various investment styles.

- ***Self-Selection.*** Many boards of small foundations are comfortable establishing portfolios by making their own investment selections. Advantages to this approach include flexibility to customize the portfolio and minimal investment expenses (assuming the individual or individuals involved work with-out remuneration). Disadvantages include: a lack of expertise or experience, which may result in diminished returns; an inability or lack of time to deal with the sometimes overwhelming mechanics of the investment process, including custody considerations and recordkeeping and; a lack of time to monitor and review holdings, which may also result in reduced returns.

Several other low-cost management options exist, including the use of a bank or other financial institution, community foundations, and the use of pooled funds such as The Investment Fund for Foundations.

- ***Use of a custodian.*** Smaller foundations or funds may choose to make use of existing relationships with the banks or other financial institutions that serve as custodians for their organizations. Because the foundation may already be paying the custodian for other services, it can often obtain competitive rates on investment management fees and other costs.

- ***Community foundations.*** In addition to their traditional grantmaking and administrative services for advised funds, some community foundations offer investment management services to private foundations. Investment management fees are generally based on the type of fund that the family has, and are sometimes negotiable. Although the investment choices available through a community foundation may be limited because of existing relationships with managers, community foundations that group funds with managers may be better able to meet minimum asset requirements, and thus may be able to secure lower investment expenses for family foundations 97 who use these services.

- ***The Investment Fund for Foundations.*** The TIFF Investment Program (TIP), a family of commingled investment funds of grantmaking foundations, is an example of a pooled fund that is open to smaller foundations. TIP's mission is to enhance the net investment returns of foundations that lack the resources needed, including a sufficient asset base, time and expertise needed to select money managers, and the bargaining power needed to obtain competitive rates to earn superior net investment returns. TIP employs a performance-based fee system, and maintains relatively low investment minimums