Institutional Investor

February 13, 2020 • Institutionalinvestor.com

PORTFOLIO

How This Small Foundation Invests Like a Big Endowment

The $440 million Orange County Community Foundation is punching above its weight with co-investments and illiquid assets.

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In Newport Beach, California, a $440 million foundation with no chief investment officer or in-house investment staff is running its portfolio like a multi-billion-dollar endowment.

The Orange County Community Foundation, which is managed by an eight-person investment committee, has adopted an investment strategy that is more active than passive, emphasizes alternative investments like hedge funds and private equity, and targets geographies and asset classes not typically found in community foundation portfolios. The result is a portfolio that looks like that of an endowment more than twice the OCCF's size.

"We've had donors that said, 'If you just invested in the S&P 500, your return would be higher,'" chief financial officer Tracy Branson said by phone. "But you also assume a lot more risk."

Branson, who serves as the main liaison between the foundation's investment committee and investment consultant, said the process of revamping the foundation's portfolio began around five years ago, following the realization that the fund's existing asset allocation strategy wasn't working as well as it should.

"After 2009, you had that big run up in equities, and around 2013, 2014 people began to feel that it's been such a long boom cycle," the CFO said. "Our investment advisor at that point in time went a titch

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Orange County Community Foundation is home to more than 600 charitable funds benefiting a wide range of causes, including human services, education, health and wellness, environment, the arts, and community development.

conservative, so we missed some opportunities for growth we would have otherwise had."

At the same time, the foundation's investment committee felt that "we were a little late getting to the alternatives party," Branson added. "So we went out and looked for a firm that could provide us with that access."

In September 2015, the OCCF hired consulting firm Cambridge Associates to advise its investment committee on strategy and manager selection. Following a review of the foundation's various asset pools — community foundations like the OCCF typically being composed of hundreds of smaller funds — Cambridge Associates helped the investment committee develop a new strategic allocation plan that was more diversified and contained higher exposures to alternatives.

"The thing that makes community foundations unique is that they have a long-term endowment, but they also have funds that are going to be spent down and they have donor-advised funds that can behave very differently," said Tracy Filosa, managing director at Cambridge Associates. "With many community foundations, when you put all those funds together, they have a portfolio that can work well with the endowment model."

For example, Branson points to the $384 million Community Foundation for Northeast Florida as another small foundation that's investing like a large endowment. With the guidance of its investment consultant, Colonial Consulting, the foundation has diversified its long-term pool across U.S. stocks, international equities, fixed income, and alternatives, including a 14 percent allocation to private equity and 12 percent allocation to hedge funds.

In the case of the Orange County Community Foundation, Cambridge Associations determined that the foundation had large enough long-term pools and high enough donations coming in to support more illiquid investments in the private markets. The foundation, which had a 2 percent allocation to private equity when it hired Cambridge Associates in 2015, now has 8 percent of its investable assets committed to private equity investments, with the eventual goal of scaling the asset class to 20 percent of the total portfolio.

Other changes included adopting a 10 percent target for real assets and 15 percent allocation to hedge funds. The OCCF has also started making co-investments — deals that are usually reserved for limited partners that can put up much larger amounts of capital.

"Not everybody can look like Yale, and not everyone should have the same portfolio and manager lineup," Filosa said. "But smaller foundations and community foundations can also make a very compelling case for why they should get access to a manager." These smaller non-profits "might need some help" identifying and evaluating managers, but "size is not necessarily a factor in being able to invest with great managers," the consultant added.

At the OCCF, Branson acknowledged that the foundation's investment committee "wouldn't be able to find a lot of these investments" without the help of an investment consultant. Ultimately, however, it is up to the committee, chaired by Paul Westhead, to make the final decisions on Cambridge Associates' recommendations. Westhead is the managing director of Rimrock Capital Management, a California-based bond manager, and several of the other board members also have investment backgrounds.

Since adopting its current strategy in September 2015, Branson said the foundation has delivered a net-of-fees annualized return of 8.9 percent, above a benchmark of 8 percent. During the calendar year 2019, the fund returned 17.6 percent, after fees.

According to Branson, the foundation's investment performance over the past four-and-a-half years has encouraged more contributions from donors — and this increase in donations, combined with the above-benchmark returns, has enabled the foundation to pay out more grants and scholarships without sacrificing growth. The ultimate goal for the Orange County Community Foundation — which already ranks in the top 1 percent for grantmaking by community foundations — is to reach $1 billion in grants by 2024.

Branson and others at the OCCF believe they are on the right track to get there.

"If you're a strong, active community foundation with good leadership, this is the right investment model for the long term," Branson said. "We have a strong belief this is the right approach."