Report on Endowments

For Information:

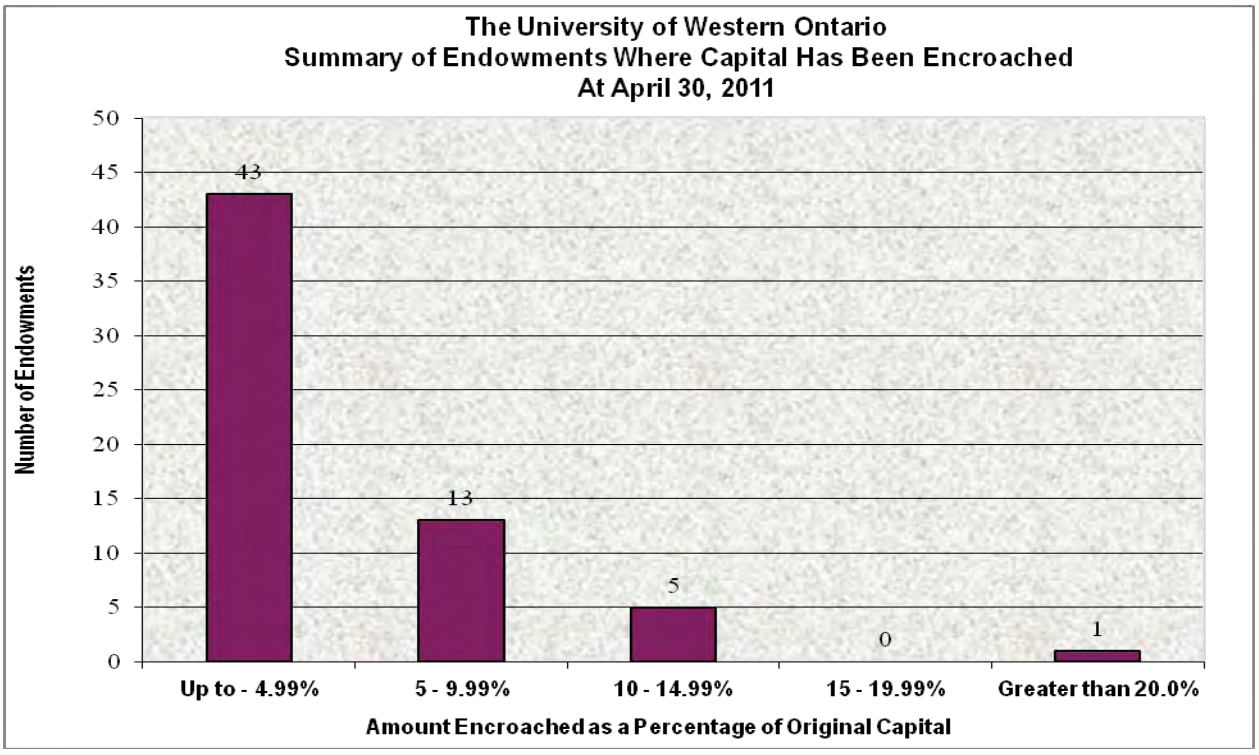
The University's policy with respect to the management of endowments permits a temporary draw down of endowment capital outlined in policy number 2.11, as follows:

> "In any particular year, should accumulated investment returns be insufficient to fund the amount made available for spending, endowment capital will be used, with the expectation that such amounts will be recovered from future investment returns."

An endowment becomes underwater when the current market value of the fund is less than the original donated amount(s).

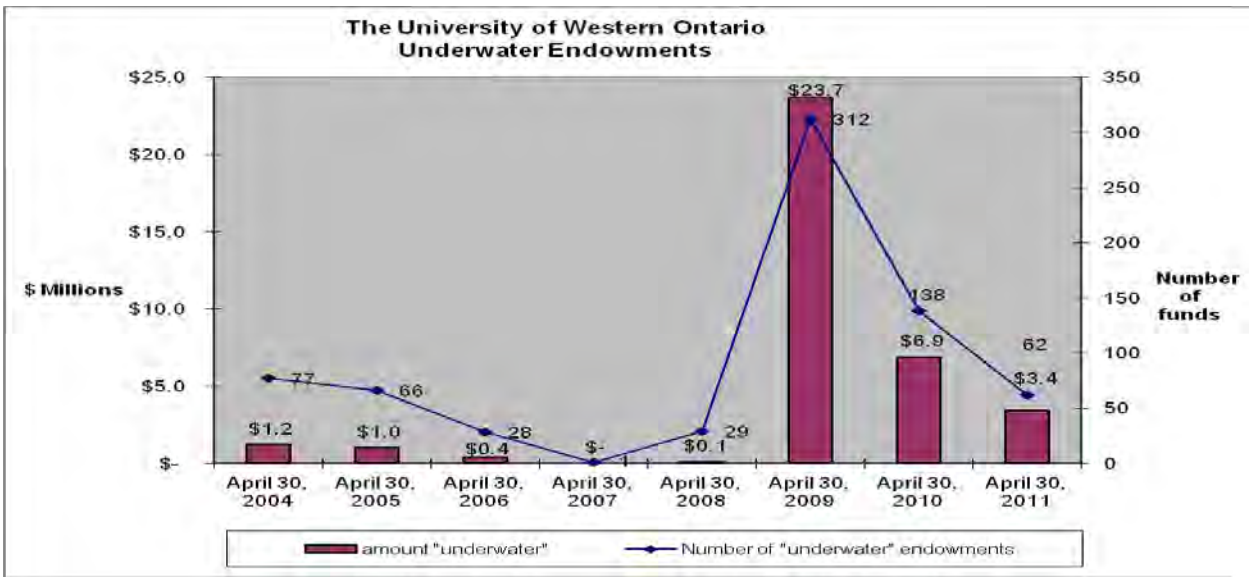
For the year ending April 30, 2011, equity markets continued to perform well providing returns of 10.4% net of fees. As a result of the positive performance, the number of underwater endowments dropped from 138 at April 30, 2010 to 62 at April 30, 2011.The number of underwater endowments represents approximately 8% of Western's endowments (18% in 2010).

The chart below provides a breakdown of the underwater endowments by the level of encroachment as a percentage of original capital.

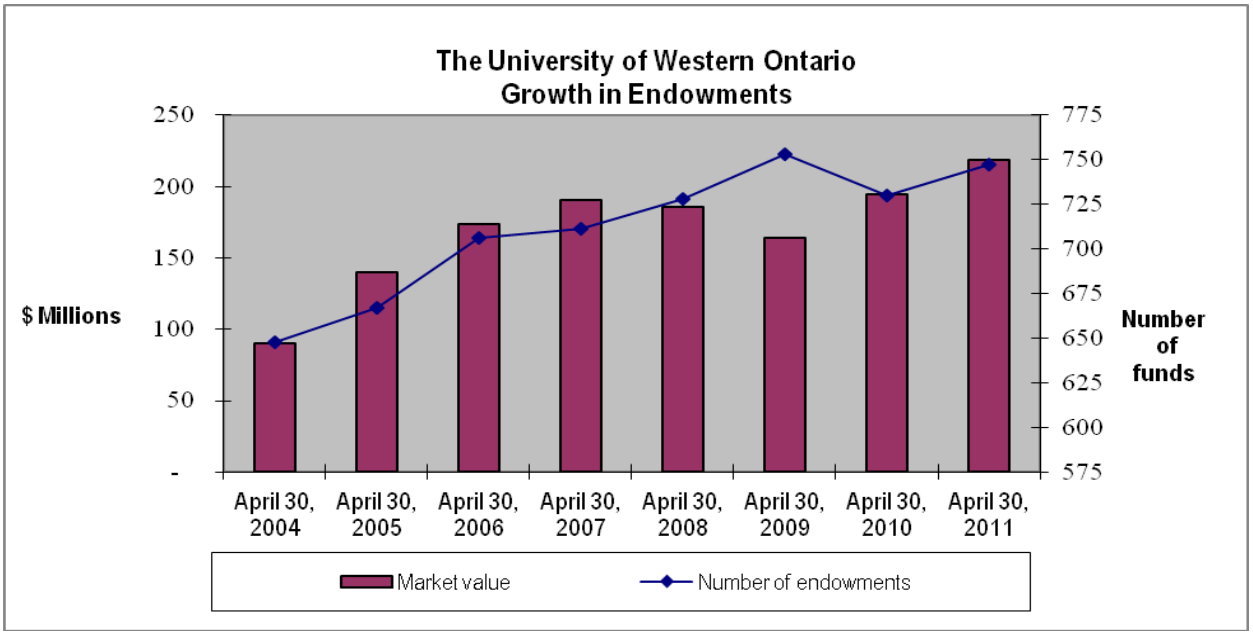


By September 30, 2011, the number of underwater endowments increased from 62 to 274 as a result of the allocation for spending and the current market volatility. The amount encroached is approximately $15.6 million.

The following chart shows the number and amounts of underwater endowments for fiscal years 2004 – 2011.



From April 30, 2004 to April 30, 2011, the total number of endowments at Western increased approximately 15%, from 648 funds to 747. Between April 30, 2004 and April 30, 2011, the market value of Western's endowments has grown by 141% from $90.4 million to $218.2 million[1].



The Investment Payout Policy was last revised in January of 2009. During the 2008 economic downturn, it became apparent that the 4.5% spending policy could not be sustained. The University looked at many

[1] These numbers include $15.7 million of OSOTF I funds that are invested by Western on behalf of Foundation Western.

different spending policies/models, including inflation adjusted models. The decision was taken to reduce the investment payout policy to 4% for the long term and to create a differentiated policy for endowments that were "underwater" (market value lower than original donated capital) at April 30th of any given year. This differentiated policy presented Donor Relations and Development with challenges regarding consistency of payouts, competitiveness and donor agreements. In addition, it created some difficulties for faculties as the actual value of the payout is not known until May 1st of any given year and is subject to relatively high volatility from year to year.

The Investment Committee engaged the services of our Investment Consultant, Russell Investments, to model payout scenarios for our endowments. The expected outcomes of the modeling were as follows:

- Maintenance of intergenerational equity
- Reduce volatility of annual allocations for spending
- Eliminate differentiated investment payout policy
- Consider divergent strategies between Foundation Western and Western
- Keep administrative effort as efficient as possible

Modeling was completed for 3.5%, 3.75% and 4% payouts from endowments, and varying averaging periods ranging from 3 years to 5 years, utilizing the current asset mix of the Operating & Endowment Portfolio.

The conclusions reached by Russell were as follows:

- A spending rate between 3.5 - 4% is generally sustainable
- Changing the averaging period does not have a significant impact on asset value but does have an impact on predictability of spending
- The current spending rule works reasonably well, especially if the averaging period is augmented. The real issue is managing community and donor expectations.
- The real return objective will need to be reduced from the current 5% to 4%
- Adjustments to the current asset mix of the portfolio will be required

From a donor relations perspective, it is very important to have a straightforward, simple rule for donors. Given this principle and in light of Russell's conclusions, the Investment Payout Policy was amended as follows:

> Effective May 1, 2011 endowed funds will be permitted to spend an amount equal to 4.0% of the average value of the total endowment over the most recent five year period. For endowments received after May 1, 2008, allocations for spending will start on May 1st of the fiscal year following their completion of one full fiscal year at Western. In the case of new endowments, the average will be calculated based upon the number of years the endowment has been at Western.