



THE UNIVERSITY OF
MELBOURNE

TRUSTS INVESTMENT REPORT 2019



1. INTRODUCTION

Every day at the University of Melbourne talented students are able to achieve their potential, regardless of personal circumstances or background, thanks to scholarships and bursaries generously given by donors, past and present. Philanthropic support provides students with access to outstanding lecturers and teaching staff who challenge and inspire them. Philanthropy also enables the University to attract and retain world-leading researchers to deliver ground-breaking discoveries that will tackle the greatest problems facing society.

This support is as essential as ever to the University's activities. As one of the largest trustees of charitable trusts in Australia, the University manages trusts (collectively, the "Trusts") with a total capital value of \$1,024.8 million.

Further information about the purpose of the Trusts can be found in Section 2.

Distribution from the Trusts in 2019 totalled \$41.0 million, supporting a range of purposes including student awards, professorships and academic positions, and the distinct activities that underpin the University's status as a global leader in the fields of higher education and research. Information about the Trusts distribution policy can be found in Section 3.

Recognising the importance of these assets to the University's continued excellence, it is the University's highest priority to ensure that these funds are well invested. Investment of the Trusts is performed on the University's behalf by two independent fund managers: the Victorian Funds Management Corporation and ROC Partners. Further information about the investment management of the Trusts can be found in Section 4.

TABLE 1: SUMMARY OF HISTORICAL TRUST INVESTMENT RETURNS & DISTRIBUTIONS

2019 INVESTMENT PERFORMANCE SUMMARY

The Trusts portfolio achieved an overall investment return of 12.3 per cent in 2019. As a long-term investor, the University is able to tolerate short-term fluctuations in the market values of its publicly-listed assets in pursuit of a superior long-term return. This approach resulted in a strong return in 2019. Further detail about the 2019 investment performance of the Trusts can be found in Section 5. The University's investments are overseen by an Investment Management Committee, which is described in Section 6.

	2015	2016	2017	2018	2019
Year End Market Value (\$m)	664.6	741.6	856.9	909.3	1,024.8
Return (%)	7.2	7.7	10.5	1.6	12.3
Trusts Distributions (\$m)	25.7	28.4	32.1	35.7	41.0

As of writing, investment markets have been extremely volatile in early 2020 due to the impact of COVID-19. Equity markets broadly have sold off to price in severe economic disruption. The University's investments have been affected but have historically outperformed equity markets in volatile times due to the multi-asset approach. The University is working closely with its fund managers to actively monitor the situation.

2. TRUSTS PURPOSE

The University of Melbourne is one of the largest trustees of charitable trusts in Australia, with more than 1,000 trusts. Over the last ten years, more than 300 new endowed trusts have been created at the University, extending the legacy established by those far-sighted donors who established the first endowment in 1863.

A majority of the individual trusts managed by the University are restricted in that they have a designated purpose and provide long-term funding for that purpose. Student awards account for the greatest number and encompass bursaries, scholarships, financial aid and prizes. Nine per cent of trusts support academics' salaries, comprising chairs, fellowships, lectureships and research assistants. Libraries and student enrichment include trusts that support study spaces and resources as well as sport and other extracurricular activities at the University.

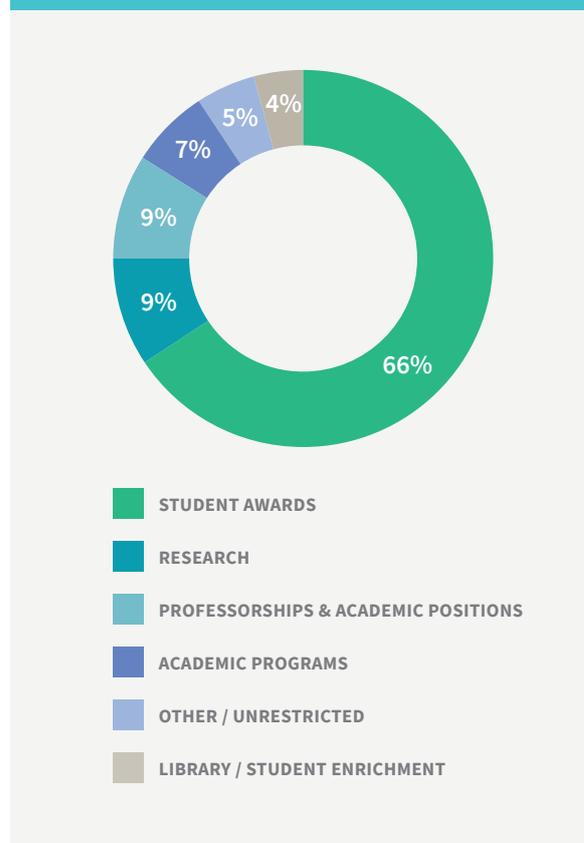
3. TRUSTS INVESTMENTS STRUCTURE, OBJECTIVES AND DISTRIBUTIONS

The arrangement of the University's investments, including its trusts, along with detailed policies describing investment objectives and distributions, is reviewed periodically. These investment objectives and distribution policy inform the strategies developed by the fund managers.

STRUCTURE

The University's overall investment portfolio is managed as two separate sub-portfolios: the Trusts sub-portfolio contains the trusts managed by the University, and the Reserves sub-portfolio contains the University's other long-term assets. Recognising that the two sub-portfolios operate over different investment horizons and have different liquidity needs, the sub-portfolios have separate investment objectives and strategies. The Trusts sub-portfolio benefits from the economies of scale arising from the size and breadth of the University's total investment portfolio through the combined management of the two sub-portfolios by the University's fund managers.

FIGURE 1. TRUSTS DESIGNATION BY PURPOSE



The Trusts sub-portfolio operates as a separate unitised fund structure. Once received, gifts and bequests are valued and exchanged for units that represent a portion of the total sub-portfolio. The value of the units varies over time in accordance with the performance of the underlying investments. Units are re-valued to the market value of the underlying fund investments each month-end.

OBJECTIVES

The objective of the Trusts sub-portfolio is to provide for scholarship, academic and research needs for current and future beneficiaries of endowments. To achieve this, the Trusts sub-portfolio is structured to:

- achieve long-term capital growth;
- provide sufficient liquidity to meet the annual payments to beneficiaries of the various underlying trusts; and
- maintain the real value of the assets into the future.

DISTRIBUTIONS

The University targets an annual average distribution rate of 5 per cent on the Trusts' value. Like many endowments, the University calculates distributions based on a smoothing function. This stabilises the distribution amounts, reduces the risk of long-term impairment of the portfolio in bad market conditions, and helps the University better predict and plan for distributions.

Calculated distributions are equal to the sum of (i) 80 per cent of the previous year's distribution amount, and (ii) 20 per cent of the target distribution rate of 5 per cent of the market value of the Trusts. To ensure that actual distributions are closely aligned to the target rate, a constraint is applied, ensuring that actual distributions

cannot be lower than 4.5 per cent or higher than 5.5 per cent of the market value of the Trusts.

This calculation occurs as part of the University's annual budgeting cycle in October each year. This means that the distribution estimate is based on the balance at the end of the year two years prior to the distribution year. Thus, the October 2018 budget for the 2019 year was based on the market value of the Trusts as of the end of 2017. To adjust for this timing difference, the Trusts market value used is adjusted for inflation (two years of inflation, to bring the 2017 market value into 2019 dollars for distribution). Similarly, the 4.5-5.5 per cent range is applied to the inflation-adjusted year-end market value from two years prior to the distribution year.

TABLE 2: TRUSTS MARKET VALUE AND DISTRIBUTIONS 2017-2019 (\$ IN MILLIONS)

The actual Trusts market value and distribution figures over the past three years are shown in Table 2 below. Calculation of the distribution can be illustrated using the figures in green for the 2019 distribution (calculated in October 2018): 80 per cent of the actual prior year (2018) distribution of \$35.7m, subject to one year of inflation, equalling \$29.3m; plus 20 per cent of the target distribution, based on the target distribution rate of 5 per cent and the most recent year-end market value (2017 year-end, being \$856.9m in 2017 dollars and \$900.3m in 2019 dollars, i.e. adjusted for two years of inflation) equalling \$9.0m. This totals the calculated distribution value of \$38.3m (\$29.3m plus \$9.0m) which was less than 4.5 per cent of \$900.3m and therefore the minimum distribution of 4.5 per cent (being \$40.5m) applied in this instance. The actual distribution amount in 2019 slightly exceeded \$40.5m due to distributions on donations received and contributed to the Trusts during the year.

	2017	2018	2019
Year-End Market Value (M.V.)	856.9	909.3	1,024.8
Latest year-end Market Value for Budget ¹	698.3	779.2	900.3
80 per cent of Actual Prior Year Distribution (+CPI)	23.3	26.3	29.3
20 per cent of 5 per cent Target Rate * prior year-end M.V. ¹	7.0	7.8	9.0
Constrained Distribution (4.5-5.5 per cent of Latest Year-End M.V. ¹)	31.4	35.1	40.5
Per cent of Latest Year-End M.V. ¹	4.50%	4.50%	4.50%
Actual Distributions	32.1	35.7	41.0
Per cent of Latest Year-End M.V. ¹	4.60%	4.58%	4.55%

¹ E.g. the "Latest Year-End Market Value for Budget" in 2019 is as of 31/12/17, as the budget is created in 2018, adjusted for CPI.

4. INVESTMENT MANAGEMENT AND STRATEGY

The University’s long-term investments are managed externally. As outlined in Section 3, the Trusts are invested alongside other long-term investments of the University to achieve economies of scale. The investment strategy is developed by the University’s investment managers with input and approval from the University.

FUND MANAGEMENT

Since 2002, the University’s investments have been managed by the Victorian Funds Management Corporation, a public authority established in 1994 through an Act of the State of Victoria.

The Victorian Funds Management Corporation is a highly-regarded institutional investor, responsible for investing over \$61 billion of funds for 30 public authorities of the State of Victoria and related organisations, including the National Gallery of Victoria, State Library Victoria and WorkSafe Victoria.

The Victorian Funds Management Corporation is also a leader in addressing issues relating to climate change risk in investments – an important consideration for the University.

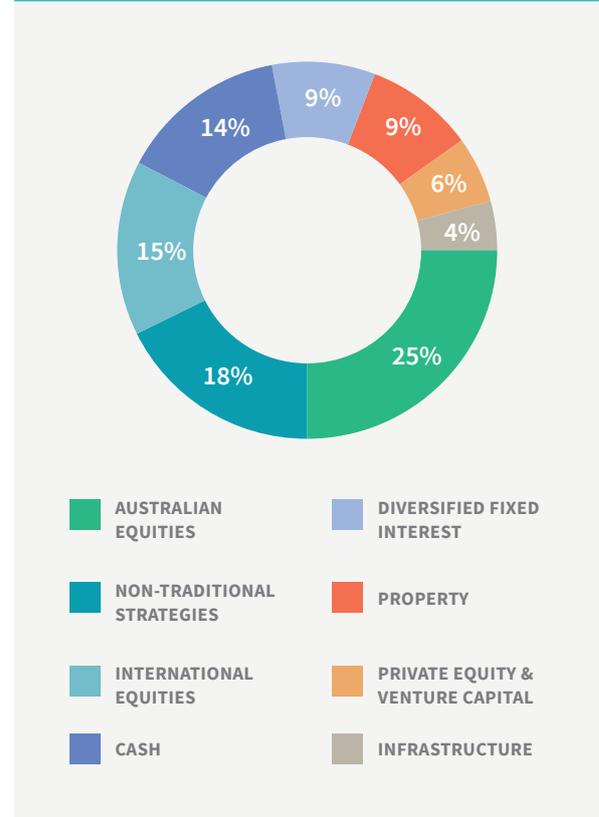
In 2016, the Victorian Funds Management Corporation made a strategic decision to cease investing in private equity and venture capital assets. The University determined that, given its investment beliefs and objectives, it wished to continue investing in those asset classes and therefore appointed ROC Partners as a second fund manager for those investments.

Both fund managers operate as “managers of managers” and invest funds with a range of commercial fund managers. Leading global advisory asset consultant Willis Towers Watson is engaged by the University to provide independent investment advice.

ASSET ALLOCATION

The Trusts sub-portfolio was valued at \$1,024.8 million as of the end of December 2019, representing 37.0 per cent of the University’s total investment assets, and consists of eight main asset classes:

FIGURE 2. TRUSTS SUB-PORTFOLIO ASSET ALLOCATION AT END OF DECEMBER 2019



The definition and allocation of asset classes comprises one of the central activities in strategy development and is subject to review on an annual basis with the University’s management, Investment Management Committee, fund managers and advisors.

Adjustments to weightings and material departures from asset allocation targets or ranges are part of monthly reporting received by the University.

TABLE 3: TRUSTS PERFORMANCE OVER TIME (AT END OF DECEMBER 2019)

% return per annum	1 Year	3 Year	5 Year	10 Year	Since Inception
Sub-portfolio Performance	12.3	7.6	7.5	7.79	8.1
Target Return (CPI +4%)	5.8	5.8	5.7	6.1	6.7

RISK (INCLUDING SUSTAINABILITY)

Like any institutional investor, the University’s fund managers have a well-developed framework for the identification of investment risks and the incorporation of these identified risks into the investment strategy.

One of the less well understood risks confronting all investors is presented by human-driven climate change; the difficulties associated with anticipating the rate and degree of change, the economic impacts, and the policy responses continue to create a high degree of uncertainty for investors.

More broadly, the University believes that Environmental, Social and Governance principles are relevant to investment decisions and has adopted a broad, institution-wide Sustainability Charter and an underlying Sustainability Plan.

Consequently, the University announced as a part of its Sustainability Plan that it would create a specific framework for considering climate change risk in its investment portfolio.

This framework was developed and approved in late 2017. The implementation of this [Sustainable Investment Framework](#) is reviewed on an annual basis.

2019 TRUSTS INVESTMENT PERFORMANCE

The Trusts sub-portfolio has performed well overall for many years despite periodic volatile global financial conditions. Table 3 shows the sub-portfolio outperforming the target return over the long-term.

2019 COMMENTARY

The global economy slowed considerably over 2019, before stabilising late in the year. This slowdown was broad-based across most key regions. The US-China trade dispute had a material impact on global trade and manufacturing. Global business sentiment was also adversely affected, leading to subdued levels of capital spending. Weak wages growth across many economies was a constraining influence on consumer spending, including Australia.

However, a subsequent material easing of monetary policy by the US Federal Reserve and other global central banks eventually offset slowing global growth. Significantly, lower global interest rates allowed equity and other asset class valuations to re-rate higher, which delivered strong risk-adjusted returns. Progress in de-escalating the US-China trade dispute also helped improve investor risk sentiment into calendar year-end.

The portfolio returned a strong 12.3 percent return and met the target return objective. The 2019 performance by asset class is shown in Table 4.

**TABLE 4: TRUST PERFORMANCE
IN 2019 BY ASSET CLASS**

Asset Class	Return %
Australian Equities	22.7
International Equities	27.2
Infrastructure	14.8
Property	5.5
Diversified Fixed Interest	7.7
Non-Traditional Strategies	4.7
Cash	2.2
Private Equity	11.4
TOTAL TRUSTS FUNDS	12.3% RETURN

5. GOVERNANCE AND ADMINISTRATION

An Investment Management Committee oversees the strategy for, and performance of, University investments. The Committee was chaired by Mr Martyn Myer AO and is composed of industry professionals, University council members and senior executives of the University, who provide advice on investment beliefs, strategy, philosophy and policy, and they oversee appointment of fund managers.

The Investment Management Committee meets regularly throughout the year and reports to the University Council through the Finance Committee. Mr Andrew Sisson AO succeeded Mr Martyn Myer AO as chair in early 2020.

The Vice-President (Administration & Finance) and Chief Operating Officer has management responsibility for the University's investments, supported by the CFO Group. In addition, a team of Advancement, Legal, Finance Operations and Compliance staff manage the expenditure of trust distributions according to the donor's intentions.

FEES

The University calculates an internal administration fee of 2.5 per cent based on distributions; this equates to roughly 0.1 per cent of the market value of the Trusts, below the administrative fees charged by other charitable trustees.

MAKE A DIFFERENCE

From its foundation in 1853, the University of Melbourne has been the fortunate beneficiary of generous philanthropic support from alumni, staff, parents and friends. The University welcomes the opportunity to discuss individual giving interests.

In line with its *Sustainability Plan 2017-2020*, the University is able to establish separate specific investment funds to accommodate donors who wish to stipulate investment parameters not currently available through the existing portfolio.

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INVESTMENT MANAGEMENT COMMITTEE MEMBERSHIP

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(Chair through 2019)**

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Company Ltd

Ms Amanda Fong

Investment Advisor/Partner,
Escala Partners Ltd

Mr Peter Scott

Deputy Chairman, Gresham
Partners Limited

Professor Emeritus Rob Brown

Professor of Finance,
University of Melbourne

Professor Paul Kofman

Dean, Faculty of Business and
Economics, University
of Melbourne

Mr Allan Tait

Vice-President (Administration
& Finance) and Chief Operating
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Ms Liliana Colla

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Equisuper

Mr Mark Leibler AC

Senior Partner, Arnold Bloch
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**Mr Andrew Sisson AO
(Chair 2020)**

Founder, Balanced Equity
Management

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Authorised by: Vice-President (Administration
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Published by: CFO Group

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