RE: ALA Working Capital (Cash) Analysis

ACTION REQUESTED/INFORMATION/REPORT:

Information Only - background on the analysis to determine if there is any excess working capital available to invest in a higher yielding manner i.e. Endowment Fund and or some other investment option

ACTION REQUESTED BY:

None at this time

OVERVIEW OF DISCUSSION:

1. Background on the genesis of the discussion
2. General methodology to be used in the analysis

PURPOSE OF RECOMMENDATIONS:

N/A at this time

DATE: January 9, 2016

BACKGROUND:

The committee will recall that one of the last actions recommended by the outgoing AED Finance (Greg Calloway) was to adjust the Working Capital policy to do two things:

- Update the Cash Management Policy to allow for the expansion of the average credit rating of the portfolio to include the investment grade ratings of AAA, AA, A, and BBB.
- Provide for an annual spending/payout (formula) for the ALA Cash Management policy

Over the years the American Library Association (ALA), through the success of its many units, has established a “Working Capital (Cash)” account which provides a significant source of revenue in the form of interest income/dividends based on market performance for the benefit of the Association. Currently policy permits drawing down the interest/dividends which provides budget support to ALA programs. This interest income is generated from the investment results of funds held in ALA’s working capital bond accounts (3) at Merrill Lynch:

- Lord Abbott – Short/Limited Duration
- Neuberger Berman – Intermediate
• Blackrock – Intermediate Tax

These accounts are primarily in bonds (94.6%) focused on a diversified mix of fixed maturities\(^1\) – Long-Term (8.4%), Intermediate-Term (25.9%), Short-Term (64.3%) and Blend (1.4%).

The purpose of the request last Midwinter was to provide a higher degree of certainty from a budget and planning perspective in order to augment the funding of the Associations’ activities i.e. general operations, as well as, to enhance the prospects of realizing higher yields on the investments. Since the implementation of these policy changes interest income has increased marginally by $3,000 - $5,000 per month.

Separately at the 2015 fall meeting of the Endowment Trustees (September 21st and 22nd), one of the major topics of discussion throughout the meeting was the need to improve and maximize the returns realized in the endowment. Enhancing support to the General Fund budget was a major consideration. In discussing support to the budget, the point was made that ALA, unlike many other organizations, does not rely on endowment proceeds to fund a significant portion of its operations. However, the point was also made with respect to the increasing need for support from the endowment in view of maturing revenue sources within the Association and the steadily increasing demands for programs and services. This fact is true for all the units within ALA, but is particularly for the General Fund where management must deal with the every two-year disruption in expected overhead from the division conferences as illustrated below:

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<tbody>
<tr>
<td>Overhead Paid</td>
<td>$1,652,971</td>
<td>$1,915,659</td>
<td>$1,549,550</td>
<td>$1,982,298</td>
<td>$1,597,304</td>
<td>$1,945,679</td>
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<tr>
<td>Annual Change</td>
<td>$ (262,688)</td>
<td>$366,109</td>
<td>$ (432,748)</td>
<td>$384,994</td>
<td>$ (348,375)</td>
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Note that the above is based on actual results and is different from the expected change on a budget basis, which is developed on the best available information and the conservative division budgeting.

As a result of the above information the ALA Treasurer and the Senior Endowment Trustee approached Chief Financial Officer - Mark Leon, with the idea of using any excess funds from the working capital accounts and investing them in the endowment fund, particularly since the returns in each area seem to be the polar opposite of each other.

\(^1\) Short-Term bonds are 1 – 3.5 years, Intermediate – Term bonds are 3.5 – 6 years and Long-Term bonds are 6+ years.
METHODOLOGY TO BE USED IN ANALYSIS:

In order to carry out this analysis a number of important factors/information need to be considered and/or used.

- Monthly level of investment balances - $29,271 as of 12-31-15
- Interest earned on the investment balances
- Daily/Monthly operating cash needs

By using this information we should be able to determine what level of cash, if any, will be available - above and beyond what is needed - to meet the Association’s daily/monthly operating needs.

*Additional Steps to be Taken* - Assuming that there will be a certain level of available funds above what is needed for operations, the next step is to determine what can be done with these funds that will likely produce returns that are higher than what is currently being produced in the working capital accounts. The Treasurer and Senior Endowment Trustee feel that the past investment results in the endowment fund are a viable option for any excess funds. As such, it should be considered as an option among the following:

- ALA Endowment Fund
- Policy Changes to the Current Working Capital Account
- A Separately Charged Working Capital Account
- A Separately Charged Endowment Type Fund

Each of the listed options will require additional work and investigation by the ALA Finance staff and the ALA Investment Advisor – Merrill Lynch, in order to determine which option presents the best chance for higher returns and least amount of hurdles from a legal, policy and process standpoint.

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<tr>
<td>Working Capital</td>
<td>-0.3%</td>
<td>2.1%</td>
<td>-1.5%</td>
<td>2.9%</td>
<td>4.8%</td>
<td>4.2%</td>
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<tr>
<td>Endowment Fund</td>
<td>-0.8%</td>
<td>7.7%</td>
<td>17.5%</td>
<td>10.5%</td>
<td>-1.5%</td>
<td>12.2%</td>
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*Through 11-30-15