



HOW MUCH ENDOWMENT LIQUIDITY IS TOO MUCH?

JOHN W. GRIFFITH | Director and Endowment Specialist

In recent years, liquidity management has been facilitated by cash yields nearing 5%. Maintaining positions in cash and bonds proved advantageous, offering solid returns with comparatively lower risk. However, the recent downturn in interest rates will present greater challenges for nonprofit organizations regarding liquidity management. Reduced interest income is likely to affect operating budgets, while diminished bond yields will negatively influence endowment performance.

Within the endowment institutions generally have two options to reduced yields. They can:

- 1) Increase exposure to equities and illiquid assets to increase their likelihood of meeting long-term return targets; or
- 2) Maintain their current risk profile, accept the possibility of lower returns and reduce their spending rate.

Few institutions can afford to lower their spending rate or underperform their long-term target. To support future growth, we believe institutions should rethink their liquidity profile and their allocation to bonds and move out the investment spectrum to risk/return options that best fit their risk profile. In this paper, we discuss how to think about your organization's liquidity needs and weigh the inherent tradeoffs between liquidity and returns.

“SUCCESSFUL INVESTING IS ABOUT MANAGING RISK, NOT AVOIDING IT.” — BENJAMIN GRAHAM

WHAT IS LIQUIDITY AND HOW IS IT MEASURED?

Liquidity refers to the ease with which an asset, or security, can be converted into cash without affecting its market price. The easier an instrument is to convert to cash, the more liquid it is. Stocks and bonds can generally be liquidated to cash fairly readily, often daily. In a normal market environment, investors typically assume they will be able to sell them at a fair market-based price should they need liquidity.

But liquidity can dry up in periods of market dislocation and investors may be forced to sell assets at discounted values. While this tends to happen infrequently, the consequences of a true liquidity crisis are dire, prompting non-profits to take every measure to avoid it.

ARE CONCERNS ABOUT LIQUIDITY WARRANTED?

No. In our experience, very few organizations—only those highly levered endowments—have actually experienced liquidity crises despite having gone through three significant market crashes in the past twenty years: the Tech Bubble, the 2008 Global Financial Crisis and most recently the COVID-19 pandemic. Instead, non-profits are facing a return crisis. For the past decade, they have struggled to meet long-term return objectives—jeopardizing their missions, since the endowment's investment returns are what sustain the organization's work in perpetuity.

The question is—how much liquidity do you actually need and what are you giving up by prioritizing liquidity?

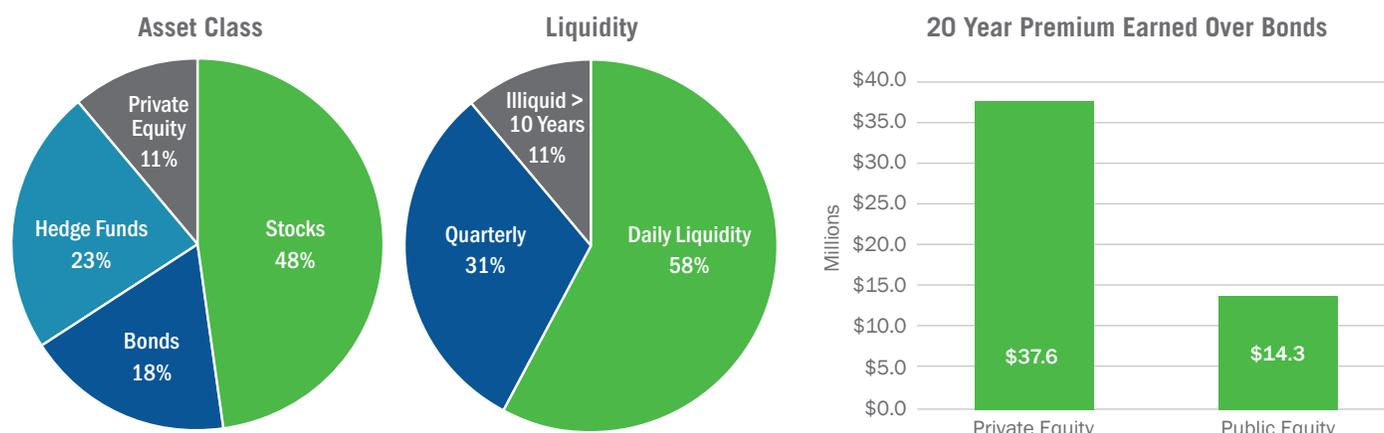
THE OPPORTUNITY COST OF LIQUIDITY

The chart below (left) depicts the liquidity profile for Non-Profit ABC’s endowment. Non-Profit ABC has 58% of its portfolio in daily liquid assets and 18% in bonds, which at first glance may seem very prudent. Many organizations pursue a similar strategy, favoring the stability, income and diversification of bonds.

However, it is important to note that there is very real opportunity cost associated with holding bonds relative to stocks and certain types of illiquid investments.

In the chart below (right), we quantify this opportunity cost by calculating the excess return that we expect private equity and stocks to generate relative to bonds. Over the past 20 years, investments in private equity and publicly traded stocks generated \$37.6 million and \$14.3 million more, respectively, than an investment in bonds.

We believe that to sustain their endowment through a lower interest rate environment, organizations will have to look further afield to achieve higher returns either through increased equity allocations or by going out of their liquidity comfort zone to commit to asset classes such as private equity, which offers the potential for outsized returns for those willing and able to commit capital for longer periods of time. Yet, there is often resistance from non-profit boards to adding illiquidity, even when they are aware of the opportunity cost of not doing so.



Source: Hirtle Callaghan

Source: Hirtle Callaghan. Based on a \$5 million portfolio. Returns are for private equity (Burgiss Private Equity Manager Universe), Public Equity (MSCI ACWI Index) relative to fixed income (Barclays Aggregate Index). Data is for the 20 years ending September 30, 2025 with the exception of private equity, which is as of 3/31/2025.

ARE ILLIQUID INVESTMENTS REALLY ILLIQUID?

To help get boards comfortable with the idea of illiquidity, it helps to clarify that liquidity is a spectrum. For example, the private equity allocation is treated as illiquid, yet private equity investments involve extensive cash flows initially funding new investments and ultimately returning capital as those investments mature.

The chart on the next page depicts the HC Cash Flows Model for a typical private equity fund investment. On average, in the sixth year of a private equity fund commitment, the cash flows turn positive with realized gains exceeding the upfront capital called to make the underlying investments. And in the first four years before a private equity investment becomes cash flow positive, the net cash outflow is approximately 65% of the total committed capital. A mature private equity program should be cash flow generative in a normal market environment.

Private Equity Cash Flows



Source: Hirtle Callaghan. The expected cash flows estimates presented are internally-generated projections, based on Hirtle Callaghan proprietary research, historical HCPE Funds' (the "Funds") data, third-party data and models. They are being provided for informational purposes only, are subject to significant limitations and uncertainty. Expected cash flows are not intended to represent and should not be construed to represent, predictions of future rates of return. Please refer to the disclosures at the end of the paper.

Organizations that have built a consistent private equity allocation over time should have the benefit of mature private equity vintages returning capital and generating positive cash flow as newer vintages are calling capital. This self-perpetuating liquidity structure should provide some security if constructed properly.

HOW MUCH LIQUIDITY DO YOU NEED?

Traditional liquidity measures don't meet modern nonprofits' needs, as they focus exclusively on asset classes and disregard cashflows. When we are undertaking a liquidity analysis, we look at the organization's operating model, including sources and uses of cash. Key questions include how much liquidity is required, projected endowment spending, non-marketable calls, special draws, and how income sources offset these demands. Factoring in these variables significantly alters Non-Profit ABC's liquidity profile, as shown in the table below.

Hirtle Callaghan Endowment Liquidity Model

| ENDOWMENT SOURCES/USES | | | STRESS TEST | |
|---------------------------------------|-----------|-----------------------|--------------------------------|-----------------------|
| Dividend Income | | \$ 1,017,182 | Reduce by 25% | \$ 762,886 |
| Interest Payments | | \$ 302,364 | Reduce by 33% | \$ 99,780 |
| Endowment Gifts | | \$ 1,650,000 | Reduce by 50% | \$ 825,000 |
| Endowment Spending | | \$ (5,610,000) | \$1M Increased Spending | \$ (6,610,000) |
| Non-Marketable Liquidity Calls | | \$ (3,400,000) | Accelerate Calls by 25% | \$ (4,250,000) |
| Return of Capital from PE Managers | | \$ 1,500,000 | Reduce Capital Returned by 50% | \$ 750,000 |
| Total Estimated Liquidity Need | | \$ (4,540,454) | | \$ (8,422,334) |
| ENDOWMENT SOURCES/USES | | | COVERAGE | |
| Fixed Income | 4.4 Years | \$ 20,157,598 | Fixed Income | 2.4 Years |
| OPERATIONS | | | | |
| Expenses | | \$ 75,000,000 | | |
| Average Cash Balance | | \$ 20,000,000 | | |
| Days Cash on Hand | | 97.3 | | |
| Operating Net Cash Positive/Negative | | \$ 800,000 | | |
| Available Line of Credit | | \$ 2,500,000 | | |

Source: Hirtle Callaghan. This example reflects an anonymized client scenario and is provided to illustrate how liquidity modeling can inform endowment planning. The data shown represent one actual client's endowment and operating liquidity. The analysis is intended to demonstrate our approach to evaluating liquidity coverage under both normal and stressed market conditions. This example is not indicative of future outcomes or results that other clients may experience. Each organization's liquidity position, spending needs, and investment objectives will differ.

We believe organizations should always maintain a minimum of two years of liquidity in the endowment to ensure a proper buffer to weather any prolonged market crisis. Liquidity over this threshold has the potential to dampen the endowment's returns and threaten the long-term viability of the organization.

In the case of non-profit ABC, with \$20.2 million in fixed income, it can cover 4.4 years before needing to sell equities, allowing time for market recovery. Even with reduced income estimates—dividends down 25%, interest 33%, and endowment gifts 50%—the bond portfolio still covers 2.4 years. This means that if the market crashed this portfolio has 2.4 years of liquidity before equities would need to be liquidated.

It is also important to incorporate Non-Profit ABC's operating liquidity into the model. Its net operating surplus, operating reserve and line of credit show that operations are cash positive with 97 days cash on hand. In the event of a downturn, it is unlikely that operations will need additional liquidity from the endowment beside the annual draw. Non-Profit ABC's average cash balance of \$20 million compared to the \$4.5 million total estimated net liquidity need suggests that in the event of a liquidity crisis, operations could forgo the draw until liquidity improved. This organization has a strong liquidity profile!

Going back to our original question—how much liquidity is too much—it seems that non-profit ABC has over-emphasized liquidity at the expense of its endowment growth. Adding more illiquidity in the form of private equity has the potential to enhance long-term returns, strengthen the endowment, and ultimately offer more support to the organization's mission.

WHAT ARE THE LEGAL RESTRICTIONS?

The final step of the liquidity review is to understand your endowment's legal restrictions. Restricted endowments (assets endowed by the donor) are subject to the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"). This act mandates that a restricted endowment's investing and spending must be at a rate that will preserve the purchasing power of the principal over the long term. As a result, excess liquidity in a restricted endowment, while comforting, is largely unusable, except to make the annual spending withdraw.

When thinking about liquidity sources, the only endowment assets you can legally spend down to address a significant operating or capital issue is the board-designated quasi endowment. Maintaining highly liquid assets in your restricted endowment does not significantly improve your organization's liquidity profile and may be an unnecessary drag on returns.

HOW CAN WE HELP YOU?

We believe the biggest risk most endowments face today is not illiquidity, but the failure to maintain purchasing power. For organizations highly dependent on endowment income, this will permanently reduce the impact your organization will have in the future. Non-profit leaders need to carefully balance the tradeoff between current liquidity and long-term investment returns. While liquidity enables organizations to meet operating needs, fund commitments and meet planned capital expenditures, too much liquidity can prevent them from realizing their long-term growth potential. At Hirtle Callaghan, we have spent over 35 years working hand in hand with nonprofits to develop sophisticated operating models, liquidity budgets and investment plans designed to meet their long-term investment objectives. We remain committed to being a thought leader in the endowment community and partnering with institutions to confront many of the difficult challenges lying ahead.

Since 1988, Hirtle Callaghan has been serving as an outsourced investment office for nonprofits and families who rely on the growth of their assets to support the causes and people they care deeply about. Our business model is intentionally designed to avoid conflicts and align decisions with the missions and goals of the nonprofits we serve. With each client in mind, we aim to design and manage fully customized investment programs that are diversified across global public and private markets. Leveraging our purchasing power, we provide access to highly vetted specialist managers while seeking to minimize costs and maximize net returns. We take responsibility for the success of each investment program, acting with the accountability of your own internal investment department.



JOHN W. GRIFFITH, CPA / jgriffith@hirtlecallaghan.com

John is a Director and Endowment Specialist with Hirtle Callaghan. He has over 35 years of nonprofit experience. John leads the firm's holistic planning process for institutions, working closely with Investment Committees to design customized investment programs that are fully aligned with their goals and risk tolerance. From 2003 until 2014, he was the Chief Financial Officer and Treasurer of Bryn Mawr College before joining Hirtle Callaghan.

As the Treasurer at Bryn Mawr, he oversaw an \$850 million endowment, managed cash, issued debt, and was responsible for budgeting and strategy planning. At Bryn Mawr, he assisted in modernizing and diversifying the endowment. During the Great Financial Crisis, Bryn Mawr was one of only a few colleges whose debt rating was upgraded. Prior to Bryn Mawr, John spent 15 years in various financial roles at the University of New Hampshire. John started his career at Coopers & Lybrand. He earned a Masters in Finance from Bentley University and a B.A. in Business Administration from the University of New Hampshire.

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