Investing Charitable Remainder Unitrusts
AT COLUMBIA UNIVERSITY
INVESTING CHARITABLE REMAINDER UNITRUSTS
AT COLUMBIA UNIVERSITY

Columbia University is fortunate to be named as the remainder beneficiary and serve as trustee of many charitable remainder unitrusts. The Office of Gift Planning at Columbia works in conjunction with the Columbia Investment Management Company (CIMC) and BNY Mellon to manage the investment of these trusts. The CIMC was formed in 2002 as a nonprofit University subsidiary that invests the endowment and takes its direction from a board whose members include leading investment experts among the University’s alumni and Trustees, in addition to several senior Columbia administrators. This structure allows experienced managers the flexibility to consider different investment strategies and vehicles. As trustee of your unitrust, Columbia recognizes its duty to protect the interest of income beneficiaries as much as its own interest in the charitable remainder. Thus the University offers two different investment strategies for unitrusts it manages—the Indexed Investment Strategy and the Endowment Return Strategy.
OPTION ONE:
THE INDEXED INVESTMENT STRATEGY

In conjunction with our investment partners at BNY Mellon, Columbia has developed three investment strategies for unitrusts that involve allocations among a variety of asset classes. Each asset class is represented by an indexed mutual fund. Compared to portfolios invested in actively managed funds, this diversification through index funds exposes the unitrust investments to less risk, allows investments to keep pace with the market, and generates lower management fees.

- The Growth Portfolio is designed for long-term growth of principal, which positively affects the income stream received by beneficiaries over time. The portfolio is weighted toward equities (65 percent) with 35 percent fixed income investments.
- The Balanced Portfolio promotes both long-term growth of principal and preservation of capital. It is invested in approximately 50 percent equities and 50 percent fixed income. This approach helps minimize market volatility and maintain the long-term purchasing power of the unitrust while providing regular payments to the beneficiary.
- The Income Portfolio primarily serves to preserve principal and generate income through an asset allocation weighted toward fixed income (65 percent). The 35 percent allocation in equities provides some diversification and potential growth. This approach helps to minimize market value fluctuations while providing regular payments to the beneficiaries.
The following chart illustrates how unitrust assets may be allocated among the various asset classes under the Indexed Investment Strategy.

<table>
<thead>
<tr>
<th>Type of Investment</th>
<th>Growth</th>
<th>Balanced</th>
<th>Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large Cap Equity</td>
<td>39.7%</td>
<td>27.5%</td>
<td>16.3%</td>
</tr>
<tr>
<td>Mid Cap Equity</td>
<td>7.7%</td>
<td>6.0%</td>
<td>4.1%</td>
</tr>
<tr>
<td>Small Cap Equity</td>
<td>4.6%</td>
<td>3.7%</td>
<td>2.7%</td>
</tr>
<tr>
<td>International Equity</td>
<td>6.0%</td>
<td>4.1%</td>
<td>2.2%</td>
</tr>
<tr>
<td>Emerging Markets</td>
<td>11.0%</td>
<td>8.3%</td>
<td>3.8%</td>
</tr>
<tr>
<td>Real Estate Investment Trusts</td>
<td>2.0%</td>
<td>2.0%</td>
<td>2.0%</td>
</tr>
<tr>
<td>US Bonds</td>
<td>21.3%</td>
<td>41.4%</td>
<td>59.9%</td>
</tr>
<tr>
<td>Emerging Markets Bonds</td>
<td>2.7%</td>
<td>2.0%</td>
<td>3.0%</td>
</tr>
<tr>
<td>High Yield Bonds</td>
<td>2.0%</td>
<td>2.0%</td>
<td>3.0%</td>
</tr>
<tr>
<td>Cash</td>
<td>3.0%</td>
<td>3.0%</td>
<td>3.0%</td>
</tr>
</tbody>
</table>

The above chart reflects allocations as of September 2012.

Columbia will work with you and/or your beneficiaries to determine the best portfolio for your unitrust.
“Even with the recent unpredictability of the stock market, the Columbia endowment has outperformed other investments. I’m confident that creating unitrusts benefiting my family was a sound decision. More importantly, these trusts will eventually provide significant support to the University for centuries to come.”

Bob Berne ’60CC, ’62BUS
OPTION TWO:  
THE ENDOWMENT RETURN STRATEGY

In December 2007, Columbia received a private letter ruling from the Internal Revenue Service allowing the University to offer to its unitrusts the opportunity to invest alongside the University’s endowment. This option is available to unitrusts if Columbia is both the sole trustee of the trust and the irrevocable beneficiary of the entire remainder interest in the unitrust following the deaths of the individual income beneficiaries.

These charitable remainder unitrusts can now achieve investment performance results close to the performance of the Columbia endowment, which has consistently outpaced the market over the past decade. If the Endowment Return Strategy outperforms the Indexed Investment Strategy in the long-term, beneficiaries of a unitrust will receive larger income distributions over time. Columbia will also ultimately benefit from the increase in the trust’s principal.

This approach allows for exceptional diversification of unitrust investments through multiple asset classes and a wide array of investment managers. It also avoids unfavorable tax issues that might arise if the trust were to invest directly in types of investments held by the endowment. However, due to the nature of income distribution from the endowment, most of these distributions are taxed as ordinary income.

While the Columbia endowment has produced strong returns in recent years, the Endowment Return Strategy may expose a unitrust to a greater level of risk compared to the Indexed Investment Strategy. Due to lessened exposure to government bonds and greater illiquidity of investments, there is an increased risk that the value of the investments will decline over both short- and long-term periods. A decrease in the value of the trust would decrease the income paid to beneficiaries of the unitrust.
HOW IS THE COLUMBIA UNIVERSITY ENDOWMENT INVESTED?

Columbia invests the majority of its own assets in a merged pool of investments subject to policies approved by the CIMC. The goal of Columbia’s endowment management strategy is to develop a well-defined investment plan that both adheres to prudent investment principles and provides the flexibility needed to add value. In this regard, management of the endowment pursues a dual objective: maintaining the real purchasing power of the endowment over the long-term while providing a reasonable and predictable level of funding for current University programs. Individual Columbia endowment funds (except those required by law or donor restriction to be maintained separately) are invested by unit share in a single aggregated pool of funds. This large pool enables the University to take advantage of different investment styles and vehicles to provide a higher total return over time while maintaining an acceptable level of risk.

Over the past 10 years, the investment returns for the Columbia endowment have been as follows:

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return</td>
<td>5.3%</td>
<td>16.9%</td>
<td>17.7%</td>
<td>18.4%</td>
<td>23.1%</td>
<td>2.0%</td>
<td>-16.1%</td>
<td>17.1%</td>
<td>23.6%</td>
<td>2.3%</td>
</tr>
</tbody>
</table>
Though past performance is no guarantee of future results and the endowment return will fluctuate from year to year, the successful results of the last decade point to the effectiveness of the CIMC model. The above graph compares the historical returns of the Columbia endowment with those of the three indexed investment strategies. While there have been years when the endowment underperformed compared to one or more of the indexed funds, the 10-year annualized return for the endowment exceeded that of all three indexed strategies. As we cannot know for certain that the endowment will continue to outperform the Indexed Investment Strategies, your unitrust should only be invested in the Endowment Return Strategy if you believe it will be the best strategy for you and your chosen income beneficiaries.
HOW DOES A UNITRUST “INVEST” ALONGSIDE THE ENDOWMENT?

The Columbia endowment is a unitized pool of assets that works like a mutual fund. It is comprised of a large number of “shares,” and the value of the entire endowment is divided equally among those shares. As the total investments grow (or decrease), the value of a share changes proportionately.

Several thousand “funds,” many of which support a specific purpose at Columbia, make up the endowment. For example, when a donor gives $250,000 to create an endowed scholarship fund, that money buys shares of the endowment at the current price of an endowed share. The value of those shares, and therefore the value of the scholarship fund, changes over time.

Under the Endowment Return Strategy, a unitrust may buy shares of the endowment and grow in a similar fashion. The unitrust’s shares are a contract right that allows participation in the endowment’s return without having any ownership interest in the underlying endowment assets.

In order to have cash available to make quarterly distributions to income beneficiaries, we maintain a small portion of the unitrust in cash, generally not in excess of 5 percent of the total value. The balance purchases shares of the endowment at the end of the month in which a gift is made.
Just as the shares of an individual fund are used to
determine its market value, they also form the basis
on which income is distributed for spending. Each
year, Columbia’s Trustees set a certain payment per
share to be distributed for spending (the “endowment
distribution”).

For example, in Fiscal Year 2013, the endowment
distribution is 60.92¢ per share; that is, a fund with
100,000 shares will receive approximately $60,920
in income to support its program. Note that the
actual income and investment return earned by
the endowment’s investments do not affect the
endowment distribution.

The current spending rule, which took effect in
1999–2000, is designed to be directly responsive to
both investment returns and the current level of price
inflation. The long-term objectives of the rule are

- to protect the corpus of the endowment by
  spending no more than the real investment return;
- to cushion spending against market volatility;
- to provide specific spending instructions and
  multiyear spending projections based upon explicit
  future investment return assumptions;
- and to respond to annual investment results as
  soon as they become available.

The endowment distribution has been between 4 and 5
percent of the value of the endowment at the beginning
of each year, but it may be different in the future. Any
investment growth or earnings not distributed during
the year remain in the endowment and affect the value
of the shares and each fund.
The unitrust agreement signed by the donor and Columbia will determine the amount of the distribution to be made to the income beneficiaries each year. That amount (the “unitrust amount”) will be a set percentage (for example, 5 percent) of the value of the unitrust assets valued on January 1 of each year. The unitrust amount distributed consists of:

- endowment distribution;
- interest earned on the unitrust’s cash investments;
- cash retained outside of the endowment;
- and, if necessary, the sale of some of the unitrust’s shares of the endowment.

It is important to note that the Endowment Return Strategy does not provide for the minimization of income taxes to be paid by the income beneficiaries. Through the Indexed Investment Strategy, Columbia tries to generate as much long-term capital gain as possible, as opposed to ordinary income, which may result in a reduced tax to the income beneficiaries.

On the other hand, the Internal Revenue Service has directed that the portion of the unitrust amount represented by an endowment distribution, which may be the most significant portion of the unitrust amount under the Endowment Return Strategy, be taxed at ordinary income tax rates. To the extent that the unitrust amount exceeds the endowment distribution, the excess may be taxed as capital gain (or capital loss).

In the early years, income beneficiaries will probably pay more income tax on the unitrust amount received from the Endowment Return Strategy than they would pay if the unitrust had been invested in the Indexed Investment Strategy. If, however, the Endowment Return Strategy outperforms the Indexed Investment Strategy by 2 percent per year on average, then after 11 to 15 years an income beneficiary would benefit from investing in the Endowment Return Strategy even on an after-tax basis.
A unitrust’s annual return will not reflect precisely the same growth as the University’s endowment for three reasons.

- Some of the unitrust will have been invested in cash, rather than in shares of the endowment, so as to maintain enough liquidity for distributions to income beneficiaries.
- Some fees may have been charged to the unitrust principal.
- The endowment return is based on appraisals and valuations that take many months to gather, and shares are valued monthly on the basis of the best available information at that time.

The investments in the Endowment Return Strategy will not be as transparent as the investments in the Indexed Investment Strategy. While you will not receive detailed information about specific investments or managers of the Columbia endowment, you will receive an annual report stating the annual return of the endowment. This report will also include the value of your unitrust as of the preceding December 31 and a general description of the asset allocation of the unitrust investments.
Columbia’s Office of Gift Planning serves the entire University, and our staff would be happy to answer questions from you or your advisers about charitable remainder unitrusts and other planned gifts. While we always recommend consulting your financial advisers, we have the expertise to discuss many different charitable vehicles that can help you support Columbia in the way that best suits your financial needs.

Please contact us for more information:

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