

Glebe Administration Board

Diocesan Endowment Report on December 2010 Quarter Performance

Introduction

1. The purpose of this paper is to report on the investment performance of the Diocesan Endowment for the December 2010 quarter.

Background

Investment Management of the Diocesan Endowment

2. Under clause 2 of the *Glebe Administration Ordinance 1930*, the principal objective of Glebe Administration Board (“GAB”) in investing the property of the Diocesan Endowment is to maintain the real value of that property and provide a reasonable income there from. Having regard to this objective, in early 2010 GAB reviewed the investment objective for the Diocesan Endowment, the investment risk tolerance, the nature of the asset classes in which the Diocesan Endowment invests, and the strategic asset allocations for those asset classes. In undertaking this review GAB was assisted by its asset consultant, Mercer Australia Pty Limited.
3. The framework for the investment of the property of the Diocesan Endowment is set out in its Investment Policy Statement, a copy of which can be found at <http://www.sds.asn.au/Site/104303.asp?ph=cb>.

Investment Objective for the Diocesan Endowment

4. The investment objective for the Diocesan Endowment is –
“To achieve a real rate of return over rolling 5 year periods of 5% per annum net of external investment management fees and adjusted for tax effects, subject to –
 - (a) preserving the real value of the Diocesan Endowment over rolling 10 year periods with a 70% probability, and
 - (b) the sum of the distributions from the Diocesan Endowment plus administrative and other costs (not including external investment management expenses) not exceeding, on average over rolling 5 years periods, 5% from 2013.”
5. Further explanation about the investment objective is set out in the Investment Policy Statement.

Asset Classes and Strategic Asset Allocation

6. The property of the Diocesan Endowment is invested in accordance with the following asset classes, strategic asset allocations (SAA) and asset class ranges –

Asset Class	Min %	SAA %	Max %
Australian Shares	15	25	35
Overseas Shares – Developed	0	18	28
Overseas Shares – Emerging	0	2	5
St Andrew’s House ¹	20	25	30
Legacy Assets ²	0	0	3
Total Growth Assets	50	70	80

Asset Class	Min %	SAA %	Max %
Australian Sovereign Bonds	0	10	20
Overseas Sovereign Bonds	0	7	20
Banking Services (net capital) ³	10	13	20
Other Cash (not included in Banking Services)	0	0	30
Total Defensive Assets	20	30	50

Notes:

1. GAB, as trustee of the Endowment, is a holder of a 50% interest in St Andrew's House (the other 50% stakeholder is Anglican Church Property Trust Diocese of Sydney as trustee of the Endowment of the See).
2. The legacy assets comprise a range of assets currently held by GAB which are being realised when the opportunity permits. By April 2011, the value of the legacy assets is expected to be less than \$50,000.
3. The strategic asset allocation for the banking services reflects the amount of capital of the Endowment allocated to the banking services activities (lending, deposit taking and treasury activities) undertaken by the Endowment.

Invested Funds

7. Since June 2010, investments in the Australian shares, Overseas shares, Australian Sovereign bonds and Overseas Sovereign bonds asset classes have been undertaken through funds operated by Mercer Investment Nominees Limited and approved by GAB. Each of these funds is a multi-manager fund, meaning that the property invested in a Mercer fund is, in turn, invested in underlying funds operated by fund managers who are specialists in the relevant asset class.
8. GAB considers that investing in multi-managed funds benefits the Endowment by –
 - (a) giving it exposure to a range of investment managers in each asset class, thus reducing the risks associated with over-exposure to any one manager, and
 - (b) requiring that Mercer, rather than GAB, monitor and assess the performance of each investment manager, and
 - (c) simplifying the investment processes of GAB and reducing the overall costs of administering the Endowment.
9. The approved funds for each of these asset classes is as follows –

Asset Class	Mercer Investment Product
Australian Shares	Mercer Socially Responsible (SR) Australian Shares Fund
Overseas Shares – Developed (hedged)	Mercer Hedged Overseas Shares Plus Fund
Overseas Shares – Developed (unhedged)	Mercer Overseas Shares Plus Fund
Overseas Shares – Emerging (unhedged)	Mercer Emerging Markets Fund
Australian Sovereign Bonds	Mercer Australian Sovereign Bonds Fund
Overseas Sovereign Bonds (hedged)	Mercer Overseas Sovereign Bonds Fund

10. The oversight of the investment in St Andrew's House, the management of the Legacy Assets, the undertaking of Banking Services and the management of cash is currently undertaken internally by staff of Sydney Diocesan Secretariat on behalf of GAB.

Measurement of Performance

11. The performance of each of the asset classes is monitored according to the indices referred to in paragraph 15. The ongoing appropriateness of each index is reviewed annually.

Risk

12. GAB monitors the risk associated with the investment of the Endowment on an ongoing basis. The ways in which risk is monitored are described in the Investment Policy Statement. Risk monitoring methodologies include the value at risk methodology, the undertaking of stress testing, and the terms of engagement of the asset consultant which require that it undertake an annual "health" check of the investment policy and investments of the Diocesan Endowment. A review of the portfolio is currently being undertaken.

Investments of the Diocesan Endowment – December 2010 Quarter

13. The following table sets out the investments of the Endowment as at 30 June 2010 and 31 December 2010 –

Assets	SAA	As at 30 June 2010		As at 31 December 2010	
	%	\$000s	% weight	\$000s	% weight
Growth Assets					
Australian Shares	25	25,499	24.6	26,752	24.4
Overseas Shares – Developed	18	16,109	15.6	17,530	16.0
Overseas Shares – Emerging	2	1,784	1.7	2,820	2.6
St Andrew's House	25	27,912	27.0	31,629	28.8
Legacy Assets	0	2,307	2.2	1,032	0.9
Total Growth	70	73,611	71.1	79,763	72.6
Defensive Assets					
Australian Sovereign Bonds	10	9,682	9.4	9,953	9.1
Overseas Sovereign Bonds	7	4,320	4.1	4,297	3.9
Banking Services	13	13,806	13.3	14,070	12.8
Investment Cash	0	2,125	2.1	1,736	1.6
Total Defensive	30	29,933	28.9	30,056	27.4
Total (Net Assets)	100	103,544	100.0	109,819	100.0

Performance – December 2010 Quarter

14. The performance of the portfolio during the December 2010 quarter and for the six months ended 31 December 2010 was as follows –

Assets	December Quarter %			July – December 2010 %		
	Return (after fees)	Index	Variance	Return (after fees)	Index	Variance
Growth Assets						
Australian Shares	3.4	4.7	(1.3)	10.4	13.3	(2.9)
Overseas Shares – Developed (hedged)	7.9	9.4	(1.5)	20.4	20.3	0.1
Overseas Shares – Developed (unhedged)	1.6	2.9	(1.3)	1.3	1.8	(0.5)
Overseas Shares – Emerging (unhedged)	0.4	1.4	(1.0)	4.3	4.4	(0.1)

Assets	December Quarter %			July – December 2010 %		
	Return (after fees)	Index	Variance	Return (after fees)	Index	Variance
St Andrew's House	11.2	1.8	9.4	13.3	3.8	9.5
Legacy Assets	3.9	1.8	2.0	5.6	3.8	1.9
Defensive Assets						
Australian Sovereign Bonds	(0.4)	(0.7)	0.3	0.4	0.3	0.1
Overseas Sovereign Bonds (hedged)	(1.3)	(1.2)	(0.1)	2.0	2.0	0.0
Banking Services	5.1	3.6	1.6	8.7	7.2	1.5
Cash	1.5	1.1	0.4	3.0	2.3	0.8
Total Return on Net Assets Vs Weighted Index	5.2	3.1	2.1	8.7	7.2	1.5

15. The performance of each asset class is measured against the following indices –

Asset Class	Index
Australian Shares	S&P/ASX 300 Accumulation Index
Overseas Shares –Developed (hedged)	Morgan Stanley Capital International World Index (ex Aust) hedged into \$A with net dividends reinvested
Overseas Shares – Developed (unhedged)	Morgan Stanley Capital International World Index (ex Aust) in \$A with net dividends reinvested
Overseas Shares – Emerging (unhedged)	Morgan Stanley Capital International Emerging Markets Free Float Index
St Andrew's House	CPI plus 5% (being the Investment Objective)
Legacy Assets	CPI plus 5% (being the Investment Objective)
Australian Sovereign Bonds	UBSW Australian Treasury Bond Index (All Maturities)
Overseas Sovereign Bonds	JP Morgan Global Government Bond Index in \$A (Hedged)
Banking Services	Benchmark return of 15% pa
Cash	Reserve Bank of Australia cash rate

Comments on Externally Managed Investments

16. Mercer has reported in writing to GAB about the performance of the investments in the Mercer multi-managed funds for the December quarter, and made a presentation to a meeting of GAB. The comments in relation to each asset class invested with Mercer can be summarised as follows.

Australian Shares

17. The investments of the Mercer SR Australian Shares Fund, in which the Endowment invests, are invested in the socially responsible funds of 3 underlying investment managers. Each of these managers lagged the benchmark for the quarter, largely due to the strength of the resources sector, which is a sector to which most SR investment managers are underweight due to environmental concerns associated with mining. In addition, one major resource stock is excluded from the portfolio of one of the underlying managers due to uranium mining and environmental concerns. The underweight position detracted from performance compared to index during the quarter.

18. At our request, Mercer is to undertake a review of its SR Australian Shares Fund during the second quarter of 2011.

Overseas Shares – Developed

19. The Overseas Shares – Developed Markets asset class underperformed the index during the December quarter due to underweight positions in the US and Canadian markets, which performed well during the quarter. However, over the 6 months to December 2010, the hedged portion of this asset class had returns in line with the index. The unhedged portion of the investment was under index principally by reason of the impact of the appreciation of the Australian dollar.

Emerging Markets

20. Emerging markets underperformed the index by reason of specific stock selections by the underlying fund managers. Over the 6 month period, performance was in line with benchmark.

Australian Sovereign Bonds

21. The Australian Sovereign Bond asset class modestly outperformed the index during the December quarter because of the short duration strategy of one of the underlying investment managers. Over the 6 month period, performance was in line with benchmark.

Overseas Sovereign Bonds

22. The Overseas Sovereign Bond asset class modestly underperformed the index during the December quarter. Over the 6 month period, performance was in line with benchmark.

Comments on Internally Managed Investments

23. The following comments are made about the St Andrew's House and banking services asset classes, which are managed by staff of Sydney Diocesan Secretariat.

St Andrew's House

24. The value of the interest in the St Andrew's House fund increased significantly, principally by reason of the revaluation of St Andrew's House as at 31 December 2010. The revaluation reflects ongoing efforts to enhance income from the building and reduce expenses of operating the building. In addition, during 2010, the debt of the St Andrew's fund has been reduced which has also contributed to an increase in the net assets of the fund and the value of the Endowment's interest.

Banking Services

25. Banking services comprises the lending, deposit taking and treasury activities undertaken by the Endowment. For prudential purposes, a portion of the capital of the Endowment is allocated to banking services – that portion is 12.5% of the total amount of the loans made by GAB from time to time. The return on capital is significantly ahead of the index by reason of income enhancement and cost control initiatives.

Performance of having regard to the Investment Objective

26. The investment objective for the Diocesan Endowment (set out in paragraph 4 of this report) can be broadly restated as the maintenance of the real value of the capital of Endowment and an additional return of 5% per annum for spending by the Synod and paying of the expenses of the Endowment.
27. As at 31 December 2009, the net value of the assets of the Endowment was \$110.7 million and, as at 31 December 2010, that value had reduced to \$109.8 million. Accordingly, during 2010, the real value of the capital of the Endowment was not maintained. The main factors impacting the failure to maintain the real value of the Endowment during 2010 were –
 - (a) the modest performance of the investment markets during 2010 and, in particular, the modest performance of the Australian share market, and
 - (b) the Australian shares portfolio of the Endowment under-performed market (generally, a stock selection issue), and
 - (c) the relatively high level of the distribution provided for in 2010 (\$5.25 million) for spending by the Synod in 2011, and
 - (d) the relatively high level of the costs of managing the Endowment.

28. The restructure of the investments of the Endowment (in particular, the settling of revised investment policies including approved asset classes and the strategic asset allocation) was undertaken in June 2010. Over the period 30 June 2010 to 31 December 2010, the value of the net assets of the Endowment increased from \$103.4 million to \$109.8 million.
29. In December 2010, GAB reported to the Standing Committee about the methodology for calculating distributions from the Endowment and has proposed a significant reduction in the amount to be appropriated from the Endowment in 2011 for spending by the Synod in 2012, compared to the amount appropriated in 2010 for spending in 2011.
30. In addition, the outsourcing of the management of the majority of the invested funds of the Endowment and the outsourcing of associated investment accounting functions, will contribute to a substantial reduction in the costs of administering the Endowment in 2011 compared to the costs in earlier years.

MARK PAYNE
Chief Executive Officer

2 March 2011