KENT
The Second Century

This special section is a perspective of Kent School's Business Manager, Jeff Cataldo, on the need for endowment growth and why KENT: The Second Century *is the School's most important strategic initiative.*


Jeff Cataldo

This article describes the School's current operating practice and condition, the competitive environment in which we operate and the importance of endowment growth, while underscoring the fact that Kent provides an exceptional educational experience that is equal to, if not better than, schools with larger endowments.

Kent's success depends largely on the hardworking faculty, administration and staff who are committed to delivering value every day. Kent is a special place where determined and intelligent students obtain an excellent education through unlimited participation in the many academic and extracurricular activities that allow for a more complete secondary school experience. A Kent student is prepared for college and for life.

Our admissions team continues to fill the School with a diverse group of smart and ambitious students who have a passion for learning. Our faculty support and prepare every student for matriculation to top colleges. We have a vibrant performing and visual arts program, and our athletic programs compete successfully against other New England schools. Kent focuses on character-building and human development, while simultaneously building an applied learning program tied to experiential and practical learning aimed at career exploration.

Kent is running on all cylinders and the School's performance is exceptional. A Kent education is worth every tuition dollar.

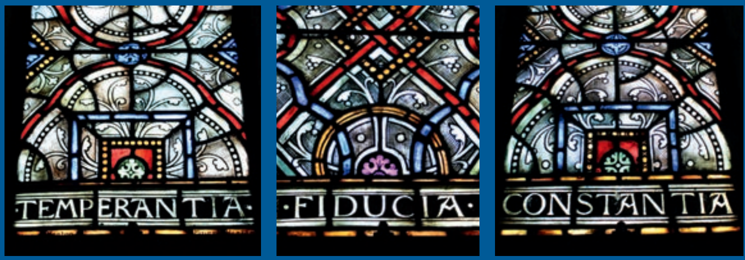
This said, the School's administrative team and Board of Trustees have the long-term success of Kent in mind, and have highlighted the need for endowment growth to secure Kent's future. A larger endowment will allow the institution to grow, improve, and meet the demands of future generations.

The value of a Kent education is tremendous and we must continue to advance Kent's value proposition. To do this, we have undertaken the initiative to increase the endowment to $250 million. This initiative is *KENT: The Second Century*.

Can we grow the endowment to $250 million in the medium term? We must!

To appreciate the need for endowment growth and the importance of the *KENT: The Second Century* initiative, it is necessary to examine Kent School's current operating model, how it has evolved and the purpose of an endowment in today's competitive independent boarding school environment. Let's start with a reminder of what was most important to Kent in most of its first century: to create a simple boarding school life that shapes competent students who can rely on themselves as they develop purpose in their lives. The standard of life at Kent has been purposefully simple. At a Saturday Night School Meeting in 1926, Fr. Sill noted:

> *"The standard of life I had in mind (when establishing Kent) was that to be found in the average country rectory. I had visited several schools and it seemed to me that they were presenting an environment which tended toward the luxurious. Their common rooms were like the lounges of the city clubs, with their huge rugs and soft leather chairs. Their dining halls and service fashioned after the style of the landed gentry of England … In spite of much criticism from other Headmasters, I have steadily insisted that economy was a worthy motive not only in the development of the Self-help system but in our boarding school life in general."* **Address on the Subject of Simplicity of Life, Self-Reliance and Directness of Purpose by Frederick H. Sill, O.H.C.; February 27, 1926**



Our experience with Kent was outstanding. Kent distinguishes itself in many ways, but most important to our family was Kent's expression of Christianity in action. Not the theology or words of the religion, but the acts of Christianity performed by Kent on behalf of our son. We are eternally grateful.

—Mr. James A. Lawrence & Dr. Mary G. Lawrence P'15

John loved Kent. The school and all he learned there were important to him all his life. I am very fortunate to be able to [support Kent in order to] benefit his school and other fortunate students.

—Susan Thomas, widow of John H. Thomas '45

I recently asked a candidate [at my company], "When in your life did you learn the correlation between focus, execution and results?" Kent was definitely the place where I learned that. When I think about what Kent meant to me as a student, it was tremendous exposure and opportunity in a caring environment. For me, the opportunity to give is to continue the educational experience and the impact it had on me for another student. To make a gift so that special spark is started in some individual—who will go out and make the world a better place—you know it will make a difference. It feels good to give. You know the cause is fundamental. [Kent's values] make the person a whole person. That's a gift that, if any of us have experienced it, we owe it to give it back.

—René Lacerte '85, Kent Trustee

Only during the last fifty years has Kent focused on endowment growth. In fact, prior to this time I would argue that the School *resisted* endowment growth and the perceived luxury that comes with endowment income.

This history has created the operating model that exists today, an operating practice that requires the School to do more with less to achieve the operating goals of: delivering necessary tuition revenue by filling the School with mission-appropriate students; providing the appropriate level of financial aid to make Kent affordable to those students who are academically qualified but cannot afford the tuition and fees; attract, yield and retain the best teachers in order to provide a superior secondary education through excellent academic programs, competitive athletics and meaningful experiential learning opportunities; investing in the campus in order to ensure a high standard of safety while creating the aesthetics and functionality expected by families.

With a total endowment of $87 million at March 31, 2017, and with an annual draw from the endowment of approximately $3 million, there has been only one way for Kent to accomplish these goals: to create what is arguably the *most productive* boarding school operation in New England. In other words, not to depend on the luxury of a large endowment but to operate with a very lean faculty, administration and staff, and use the labor savings to deliver an educational experience similar to those schools that have four to five times the endowment value ($350 to $450 million in gross endowment). We also limit investment in the campus by focusing on functionality rather than on aesthetics and excess.

To be more specific, our financial objective is to maximize the operating revenue available for teacher salaries and professional development, for scholarship assistance and for program improvement. Several schools that operate in the same market with the same mission and approximately the same number of students (540 to 600 students) *rely on five to six times the endowment income*, or $15 million-plus in endowment spending, to fund a very similar educational experience.

As business manager, I must constantly review the question: Can our School effectively compete with an endowment value of $87 million dollars in a market that needs more scholarship aid, requires the best teachers, programs and facilities, and equates reputation with endowment size? The brutally honest answer is: *No.*

Therefore, we must reach our goal of increasing the School's endowment to $250 million by the year 2020. A larger endowment is not meant to steer the School away from its founding principles, which are clearly based in simplicity and economy—but we must accept that we are operating in a market where more families are questioning the value of an independent boarding school education or are not willing to explore this value. All families expect a differentiated education, outstanding facilities, high quality extracurricular activities and athletics, academic and human development support and a superior reputation. While simplicity and economy can remain integral to the Kent experience, over time a larger operating investment to expand our market—through scholarships while advancing teacher salaries and enhancing programs—will be necessary to compete with our peers. Tuition increases and/or further cost reductions will *not* provide the financial resources necessary to fund this required step-up in investment. ***Significant endowment growth, which produces more endowment income to fund operations, is the key to a future whereby Kent continues to operate in league with New England's most elite boarding schools.***

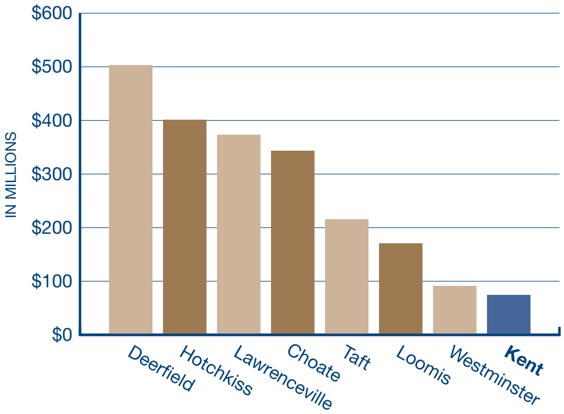
Let's examine the New England independent boarding school endowment landscape by taking a closer look at our closest competitors: the seven schools with which Kent has the greatest frequency of crossovers in the yearly student application process.

The graphs on the following page show that Kent's seven closest competitors have a significant funding advantage: they have a larger revenue base provided by more endowment income and theoretically should be able to provide a superior program. These schools are less tuition dependent and thus have more flexibility in tempering tuition increases, granting high levels of financial aid aimed at improving student quality, and/or improving student-to-faculty ratios. Kent, on the other hand, is very tuition dependent, with approximately 83% of gross operating revenue coming from tuition. We do not have the operating flexibility that our well-funded competition enjoys.

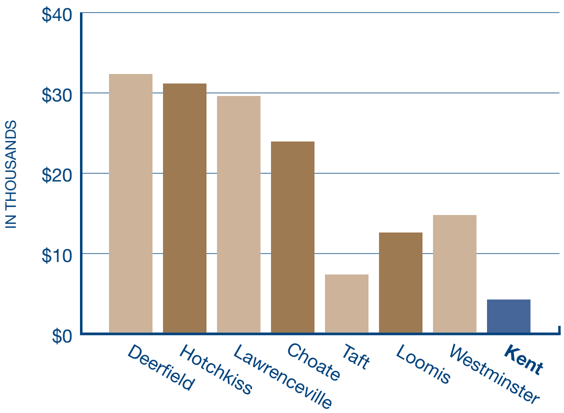
In my opinion, tuition-capable families will not continue to tolerate tuition increases to fund the growing operating investment that New England independent boarding schools are making. Going to Kent is a privilege, yet more parents are considering many other good options, among them good public and day schools, and online learning. Further, weak economic growth and market uncertainty cause many tuition-capable families to resist the high price of an independent boarding school education, while many who explore boarding school qualify for a significant amount of financial aid.

All schools are committed to enhancing their competitive position by improving their reputation through academic rigor, small class sizes, diversity, impressive college acceptances, career counseling, state-of-the-art facilities, athletic championships, award-winning artistic performances and visual art pieces, applied and experiental learning, and new programs. Our well-funded competitors can fund these initiatives through endowment income and thereby improve their value proposition. In an already lean operating environment, Kent will be at a disadvantage: there is little cost that can be removed from the institution in an effort to allocate operating revenue to necessary growth and improvement. Over time the Kent experience will fall behind that of our competitors. While maintaining cost discipline and driving productivity gains, the School *must* increase its revenue base by producing more endowment income.

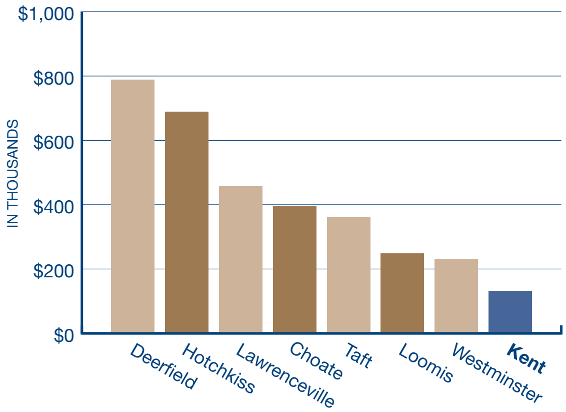
The graph below shows the operating revenue profile of New England boarding schools with a similar student size (540–600 students).



ENDOWMENT VALUE*

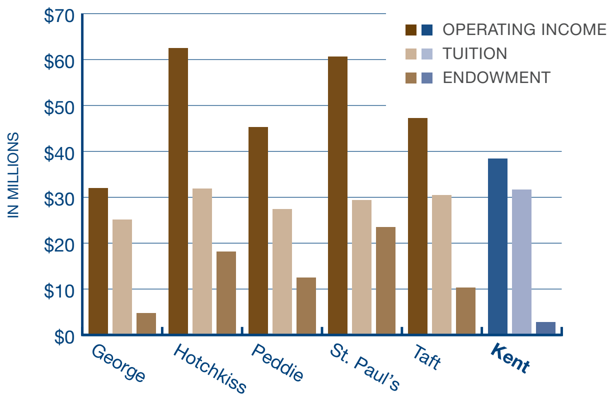


ENDOWMENT OPERATING DRAW PER BOARDING STUDENT

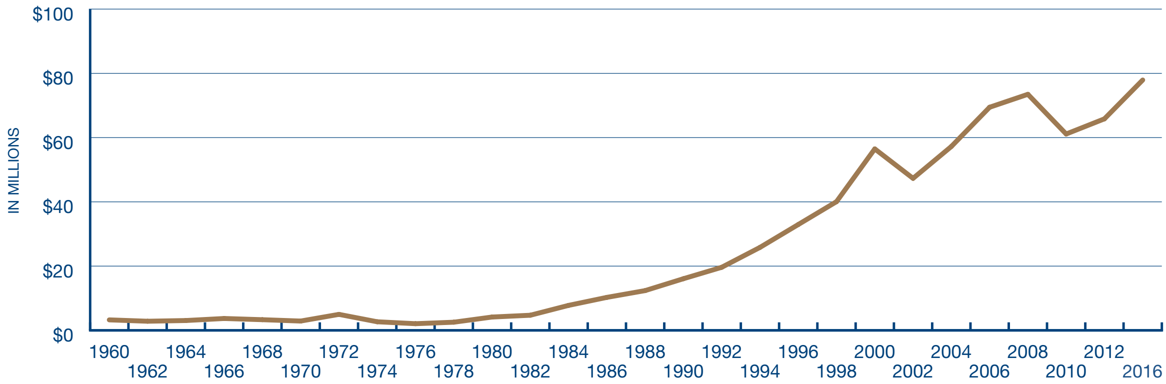


ENDOWMENT PER STUDENT*

*as of June 30, 2016



TUITION & ENDOWMENT REVENUE (AS PERCENTS OF OPERATING INCOME)



KENT SCHOOL ENDOWMENT GROWTH

A concentrated revenue base that consists of 80%-plus tuition revenue and little endowment income *is not sustainable* in the market where we operate. This has been recognized by the Board of Trustees and Kent's senior administrative team, hence the goal of increasing the endowment to $250 million via the *KENT: The Second Century* initiative. We believe that this is the endowment value necessary to operate an elite New England boarding school of approximately 570 students. A $250 million endowment would have increased the 2015–2016 fiscal year operating revenue by approximately $7 million—assuming a 4% draw of endowment value—resulting in gross tuition revenue and endowment revenue representing 69% and 22% of total operating revenue, respectively. The graph on the previous page suggests Kent School needs a revenue mix whereby endowment income equals at least 20% of total operating revenue.

A $250 million endowment at Kent is reasonable and appropriate when reviewing the revenue profiles that exist at similar New England boarding schools and considering the cost to be added to the institution over time. A larger endowment will not provide luxury and excess; it will provide the funding necessary *to maintain our position as one of the finest boarding schools in New England*.

Now that I have made the case for a larger endowment and made the claim that Kent's competitive position will weaken over time due to a lack of endowment resources, I am sure there are many questions. Here are a few questions that I have studied.

Why has the School not been able to grow the endowment to an appropriate level—what has the School been doing for the last 50 years?

The endowment has been growing, but from a low base. The best way to answer this question is to review the chart above, which shows a very impressive endowment growth trajectory. Remember, Kent's approach to boarding school education was to resist endowment and the possible excess that was contrary to a simple boarding school life.

Since the mid-1980s endowment growth has been a priority. We have recognized the importance of endowment income in operating the School. *The Campaign for The Permanent Kent*, which ran from July 1998 through December 2005, added approximately $33 million in cash gifts and $30 million in deferred gifts and pledges that continue to be collected (approximately $25 million to support current operations and campus projects was also raised). In the more recent past, we have grown the endowment dramatically. However, we began with an endowment value in 1980 that was substantially smaller than that of our peer schools. Further, the endowment that existed in the 1960s was used to establish the girls campus. In the 1970s the endowment funded operating deficits. This spending in the '60s and '70s left the School with an undersized $3 million endowment in the early 1980s.

Despite the lack of endowment funding, under the exceptional leadership of Headmaster Dick Schell and the tireless efforts of the faculty and staff, all that has been excellent about Kent remains, and Kent's performance on all fronts has improved. The operating and financial strength of the School is much improved given the consolidation of the two campuses in the early 1990s and the mandate that the School operate with a balanced budget. The Headmaster's leadership, along with the advice, guidance and strategic direction provided by the Board of Trustees, has resulted in a stronger foundation for future generations—remarkable results given the lack of financial resources available to the School.

Why give to the endowment?

A donor gives a gift to the endowment or creates an endowed fund to generate income that provides *permanent funding* to the School. The endowment is considered a permanently restricted asset; the original gift is never spent. The gift is invested in a manner to preserve the purchasing power of the gift so that the income generated can support the general mission of the School in perpetuity. Endowment giving is meant to secure the financial strength of the institution *over the long term*.

What makes up the endowment?

Kent's endowment is made up of a variety of funds earmarked for different purposes. Most funds have been established by virtue of gifts made in a donor's lifetime or as bequests in their estate to be held by Kent in perpetuity with special restrictions imposed by the donor as to their use. These funds are identified as *permanently restricted endowment funds*. Other funds have been added to the endowment by donors who have given generously over the years with no purpose restriction, and the income on these permanently restricted endowment funds can be used for *general purposes*, that is, no restriction exists as to how the investment income will be used. Lastly, several endowment funds have been established by the Board of Trustees. In this instance gifts have been made to the School with no designation as to the type of gift and, as is common practice, the Board designates the gift as endowment and classifies the gift as board-designated quasi-endowment. These gifts are classified as *unrestricted endowed funds* (the original gift can be spent). The investment income generated by these funds is not restricted as to purpose and can be used to fund the general operation of the School.

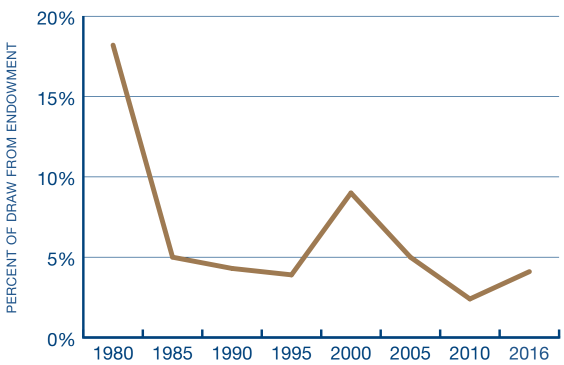
How is the endowment managed?

To properly answer this question we must consider the roles assumed by the Administrative Leadership Team, the Investment Committee (acting on behalf of the Board) and the Investment Advisor.

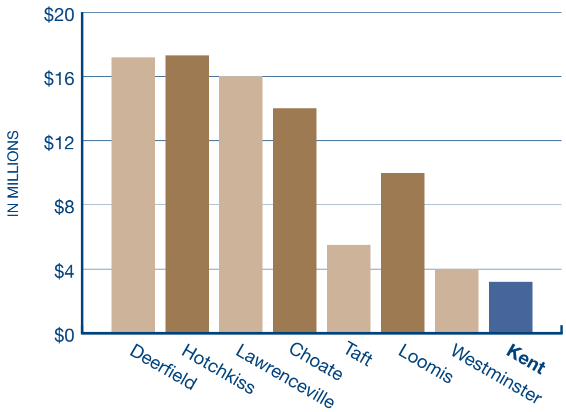
Administrative Leadership

Donor Intent: The School's Businesss Office and the Alumni and Development Office maintain the controls necessary to protect donor intent. When a donor expresses intent clearly in a written gift instrument, the School ensures that expenditures from restricted endowment funds follow the donor's instructions.

Endowment Spending: The School's Business Office makes a recommendation annually to the Board as to how much investment income should be spent to support the School. Since the early 2000s the Board has followed a policy of appropriating for distribution each year 4% to 6% of the endowment fund's fair value, as calculated by applying 50% of the average "real return" for the previous five-year period to the average portfolio value for the last three-year period. In establishing this policy, the School has considered the long-term expected return on its endowment. Accordingly, over the long term, the School expects the current spending policy to allow its endowment to grow on an annual basis. This is consistent with the School's objective to maintain the purchasing power of endowment assets held in perpetuity, as well as to provide additional real growth through new gifts.



HISTORICAL SPENDING RATE
AS OF JUNE 30



ENDOWMENT DRAW

Pooling: The School pools the various endowment funds for purposes of management and investment. In other words, investment and spending decisions are made at the pool level vs. decisions that would apply to individual endowed funds. The Business Office has established an accounting process to allocate investment income, appreciation, fees and spending to each endowed fund. This process is reviewed annually as part of the financial statement audit conducted by an independent accounting firm.

Investment Committee

Asset Allocation: The Investment Committee of the Board of Trustees is charged with the responsibility of setting the asset allocation for the endowment portfolio. The Committee focuses on diversifying the portfolio as part of its overall investment strategy—having risk and return objectives reasonably suited to the endowment fund and the institution. The Investment Committee meets quarterly to review general economic conditions, specific market concerns and current performance by asset class. A report describing current asset allocation and performance is delivered by the Investment Committee Chairman to the full Board of Trustees at every Board meeting.

Managed Assets—Current Assets Allocation*: Domestic equity 46%, international equity 6%, fixed income 25%, alternative investments 10 %, commodities 4% and cash 9%, *as of March 31, 2017.

Manager Selection/Monitoring: The Investment Committee is responsible for selecting investment managers by asset class. A manager is selected after the entire committee has had the opportunity to perform the due diligence necessary to study the investment team, investment philosophy, performance and fees. The committee expects managers to have at least $1 billion under management, 15 years of experience and at least five institutional clients. The endowment portfolio is currently using 15 managers across six different assets classes: domestic equity, international equity, master limited partnerships (equity-like), fixed income (domestic and international), commodity (broad-based commodity exposure) and alternative investment strategies (long/short strategy). The committee meets with all managers during the year. Each manager discusses performance vs. benchmark and reviews their detailed investment strategy. The entire committee considers both short-term and long-term performance, construct of investment team, changes to investment style and philosophy, largest holdings, security purchases and sales, and total assets under management. Managers are responsible for security selection as guided by a mandate provided by the Investment Committee.

Liquidity Review: The Investment Committee works closely with the administrative team to review the cash needs of the School. Both the committee and administrative team consider the needs for liquidity and have a bias toward maintaining a liquid endowment portfolio.

Investment Advisor

The Investment Committee has engaged an investment advisor for three primary purposes:

1. To assist the Investment Committee in making asset allocation decisions. The advisor studies endowment-specific investment trends and forms an independent opinion on general economic issues and market-specific concerns. The advisor shares opinions and facts as an input to the asset allocation process.
2. To assist the Investment Committee in identifying specific managers. The advisor collects data and establishes a manager profile allowing for a complete and accurate review of all prospective managers.
3. To report to the Investment Committee. The Advisor Report provides a detailed comparison of manager performance against their assigned benchmark, while also

providing asset class composition by manager and for the overall portfolio. This reporting is critical to the ongoing management of endowed assets.

What kind of endowed funds make up the endowment?

Scholarship Funds underwrite need-based financial aid and associated socioeconomic, ethnic or cultural diversity.

Teacher & Faculty Support Funds underwrite teacher salaries, stipends for distinguished performance, sabbaticals and professional development.

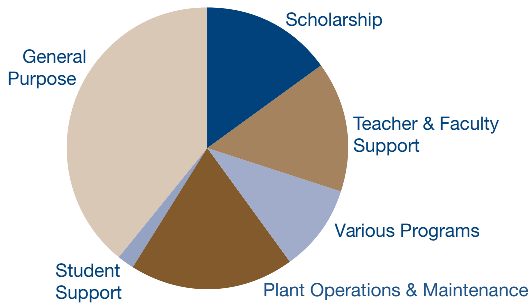
Program Specific Funds support the library, athletics, St. Joseph's Chapel, academic disciplines, the visual and performing arts, applied learning, technology, and visiting scholars and speakers.

Plant Operation & Maintenance Funds support the ongoing operation and maintenance of the campus.

Student Focused Funds provide funding for student awards, Prize Day, leadership development, experiential learning, community service, and collaborative student/faculty initiatives.

General Purpose Funds are used at the Board's discretion to fund the mission of the School.

These funds have been established by donors with the foresight to see value in the long view and thoughtfully take steps to help the School secure a foundation for future generations.



ENDOWMENT FUNDS

Why not rely on more debt to fund program growth?

The School has effectively issued tax-exempt debt through the State of Connecticut Health and Educational Facilities Authority (CHEFA). This debt has been used to advance the School's mission by funding the construction and renovation of important spaces on campus. When considering necessary investment in the campus, tax-exempt debt is considered as part of the funding strategy. At July 1, 2017, the start of the next fiscal year, Kent School will have $26.8 million in debt outstanding. Based on a detailed review completed by Standard & Poors as well as internal analysis completed with the Finance Committee of the Board of Trustees, Kent School is at full debt capacity given its single "A" credit rating. Additional debt service could not be funded by operating cash flow (excludes endowment draw). The Board of Trustees will monitor the School's debt profile and assess the value that can be created by adding more debt. The current strategy is to remove interest rate volatility, which has been done by creating a fixed debt portfolio and to allow for the scheduled pay-off of debt with operating cash.

There are always productivity initiatives that can be executed: why not focus on more cost reduction?

The School has created an operating culture that features cost control and reduction. Current operating practice already calls for limited operating investment in labor, campus maintenance, campus additions and improvements and other operating costs. To have a meaningful impact on cost there are several operating lines to study: salaries and benefits (40% of total operating cost), financial aid (20% of total operating cost), utilities (5% of total operating cost) and campus maintenance, including capital investment (5% of total operating cost). Every year the Business Office identifies and executes productivity gains even though *major costs have been cut to industry lows*. We operate with an extremely lean employee base to limit cost and to ensure we are paying teachers competitively. The commitment to improving academic quality and diversity requires a significant investment in financial aid; an investment we should continue to build rather than cut. We are always hedging utility cost in an attempt to be opportunistic and lock in low pricing while removing budget volatility.

Lastly, campus repair, additions and improvements are always focused on safety and functionality with little room if any to reduce this expenditure. It is clear that the School has always put cost control first and operates efficiently; it is time to focus on non-tuition revenue growth. As we execute *KENT: The Second Century* the School will also focus on other commercial opportunities to expand non-tuition revenue. There is opportunity to grow fee-based revenue that can be earned by renting facilities and leveraging our programs to bill and earn more fee-based income.

What should I do?

Headmaster Dick Schell and Alumni & Development Director Kathy Nadire—with support from the entire A&D team and a team of volunteer leaders—are cultivating support in order to meet the goal of *KENT: The Second Century*. Very generous gifts are being made by alumni, parents and friends of Kent. The School's operating plan has reached record lows as it relates to its draw from the endowment, thereby supporting endowment growth. Under-utilized assets are being examined to assess the value of monetizing these assets and contributing cash proceeds to the endowment. The Investment Committee of the Board of Trustees, led by Committee Chair Robert F. Hoerle '52, is closely managing asset allocation and delivering a net return in excess of benchmark. We are on a path to reach our goal, but your participation is critical.

It is the generous financial support provided by alumni/ae, past and present parents, and friends of Kent that allows your School to provide the exceptional education that is shaping the lives of so many young students. ***Your support is critical to the long-term success of the School***. It is important to highlight the structure of the fundraising program and how you can participate. The objective is to have Kent stakeholders allocate their giving to Kent School via three fundraising programs.

On an annual basis Kent constituents should consider giving to Kent School in the following manner:

Annual Giving is a recurring gift to Kent School to subsidize general operations or a more specific recurring gift to support a specific operation (athletics, chapel, scholarship, teaching, etc.).

Endowment Gift is a recurring gift to Kent School to build an endowment fund to create income that will be spent to subsidize the ongoing operation of the School. The gift will not be spent. The income on the gift will be spent in accordance with the stated purpose restriction or on general operations, per donor instruction.

Planned Gift is a gift to Kent School organized during the donor's lifetime to identify a planned giving vehicle (charitable trust, estate plans, annuity, pooled income fund, life insurance policy, beneficiary interest in certain assets) and a future value to be collected by the School at a future date. This gift, once collected, will be contributed to the endowment as directed by the donor.

Given the outstanding results being delivered by our faculty and students, I realize that this article might not be as uplifting as one would expect. I often hear that Kent School does a great job "punching above its weight," providing an exceptional educational experience that is equal to or better than many schools with larger endowments. All associated with Kent should be proud of their School. Yet, we should examine the School through a long-term lens and realize that now is the time for every Kent stakeholder to consider what part they can play in growing the endowment.

I look forward to doing the work necessary to ***secure Kent's Second Century***. Please join the hundreds of Kent alumni/ae, parents of alumni/ae, grandparents and friends who support Kent.

A graduate of the University of Rhode Island (BS in Business Administration) and Rensselaer Polytechnic Institute (MBA), Jeffrey Cataldo as a Certified Public Accountant had a career with Coopers & Lybrand, now PricewaterhouseCoopers, as an independent accountant, and with various corporations in treasury and business development roles, the most recent with Stanley Black & Decker as assistant treasurer and director of business development. Mr. Cataldo joined Kent School in September 2008 as controller & director of business services, transitioning into the role of business manager & CFO in June 2012. He is the father of Brett '16 and Emily '18.