



Church Endowments & Spending Rules

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What is the Episcopal Church Foundation (ECF)?

Overview:

- Independent and lay-led foundation
- ECF's mission is to strengthen the **leadership** and **financial** capabilities of Episcopal congregations, dioceses, and other institutions
- ECF carries out this mission through a wide array of programs including...



Leadership Resources

- ECF Vital Practices (ecfvp.org)
- Vestry Resource Guide
- Fellowship Partners Program
- Educational Events
- Vital Teams

Financial Resources

- Capital Campaigns
- Planned Giving
- Endowment Management
- Educational Events

A Short History of the Legal Structure of Non-Profit Endowments

- As Trusts (English Law)
- As Corporations (American Law)
- The Prudent Person Rule & Resulting Investment Problems
- UMIFA (1972) Introduces Endowments to Modern Portfolio Theory
- UPIA (1994) Modernizes Trust Law
- UPMIFA Unifies the Experience Gained



UMIFA Principles

- *Asset should be invested prudently in diversified investments seeking both growth and income*
- *Appreciation of assets can be spent prudently for the purposes of the endowment, not only "income"*



UPIA Principles

- *Invest as Prudent Investor vs. rather than Prudent Person*
- *Diversify assets*
- *Delegate investment responsibility to professional (can relieve trustee of liability)*
- *Avoid unnecessary costs*



How Key Elements of UPMIFA Apply to Church Endowments

- Provides Direction for both True and Quasi Endowments
- Rescinds "Historic Dollar Value"
- Removes "Income Only" Restriction
- Defines What "Prudent" Means



The Difference between Donor-Restricted and Board-Restricted Funds

- Donor-Restricted “True” Endowment Funds
- Board-Restricted “Quasi” Endowment Funds
- Investing as One
- Spending as Two
- Protecting the Corpus



UPMIFA Standards for Investment

- *General Economic Conditions*
- *Possible effect of inflation or deflation*
- *Tax consequences (if any)*
- *Role of each investment within overall investment portfolio*
- *Expected total return*
- *Other resources available to the institution*
- *The need to make distributions and preserve capital*
- *An asset's special relationship to the institution (if any), otherwise, diversify*



UPMIFA Standards for Spending

- *Duration & preservation of the fund*
- *Purpose of the institution and the fund*
- *General economic conditions*
- *Possible effects of inflation or deflation*
- *Expected total return*
- *Other resources of the institution*
- *Investment policy of the institution*



Delegation of Management & Investment Function

- *Allows decision makers to delegate management and investment decisions if care is made in selecting the agent and reviewing performance*
- *Does not allow decision makers to delegate spending decisions*
- *When properly delegated, decision makers are protected from liability for actions of agent*
- *Decision makers to assure only "reasonable" costs for delegation*



Common Issues Regarding Spending Rules

- *Spend "as needed"*
- *Spend "income only"*
- *Take extra draw in good years*
- *Don't spend until corpus reaches a certain threshold*



Primary Goals of a Spending Rule

Spend Something

and

Maintain the spending power of the endowment



Setting a Spending Rule Policy Using Total Return

- Determine a rolling average net asset value (NAV)
- Set a percentage of draw
- Be consistent
- Keep it simple (although there are many variations)



St. Swithin's, Swampland – Total Return Calculation

Three-Year Average & Annual Draw Percentage

General Endowment Draw for 2010

<u>12/31/2007</u>	<u>12/31/2008</u>	<u>12/31/2009</u>	<u>3-Year Average</u>	<u>4% draw</u>	<u>3% draw</u>
199,276.10	132,274.14	164,043.76	165,198.00	6,607.92	4,955.94

General Endowment Draw for 2011

<u>12/31/2008</u>	<u>12/31/2009</u>	<u>12/31/2010</u>	<u>3-Year Average</u>	<u>4% draw</u>	<u>3% draw</u>
132,274.14	164,043.76	186,951.92	161,089.94	6,443.59	4,832.69

General Endowment Draw for 2012

<u>12/31/2009</u>	<u>12/31/2010</u>	<u>12/31/2011</u>	<u>3-Year Average</u>	<u>4% draw</u>	<u>3% draw</u>
164,043.76	186,951.92	177,421.89	176,139.19	7,045.56	5,284.17

General Endowment Draw for 2013

<u>12/31/2010</u>	<u>12/31/2011</u>	<u>12/31/2012</u>	<u>3-Year Average</u>	<u>4% draw</u>	<u>3% draw</u>
186,126.73	177,421.89	220,248.28	194,598.89	7,783.95	5,837.96

General Endowment Draw for 2014

<u>12/31/2011</u>	<u>12/31/2012</u>	<u>12/31/2013</u>	<u>3-Year Average</u>	<u>4% draw</u>	<u>3% draw</u>
177,421.89	220,348.28	268,088.57	221,952.91	8,878.81	6,658.58

Spending Rule Calculation

Here is a simple calculation we use to help endowment boards think through the implications of spending rules.

• Spending Rate	5%	4%	3%
• Inflation	2%	2%	2%
• Fees	<u>1%</u>	<u>1%</u>	<u>1%</u>
	8%	7%	6%

Linking the Spending Rule to Investment Decisions

- Do you have an investment policy?
- What is the “right” allocation for the “right” draw
- Factoring in historic returns and future forecasts



Considering Expected Returns

Expected returns based on long-range asset class forecasts as of December 2014:

70/30 Equities/Fixed Income – 6.18% annualized over three years *

60/40 Equities/Fixed Income – 4.82% annualized over three years *

Spending Rate	5.00%	4.00%	3.00%
Fees	1.00%	1.00%	1.00%
Inflation	<u>2.00%</u>	<u>2.00%</u>	<u>2.00%</u>
	8.00%	7.00%	6.00%
Expected Return on 70/30	<u>7.00%</u>	<u>7.00%</u>	<u>7.00%</u>
Difference	(1.00%)	0%	1.00%

* Investment managers hope to outperform this by 50-100 bps

Endowment Spending Rule Variations

- **Simple Rules**
 - Income Only
 - Set Rate Each Year
 - Spend Pre-Specified Percentage of Beginning Market Value
- **Inflation-Based Rules**
 - Grow Distribution at Predetermined Inflation Rate
 - Spend Last Year's Draw Plus Inflation (but with Upper and Lower Bands)
- **Smoothing Rules**
 - Moving Average
 - Spending Reserve
 - Stabilization Fund
- **Hybrid Rules**
 - 80% of Prior Year's Spending, Plus 20% of Spending Rate Times NAV
 - 60% of Prior Year's Spending, Plus 40% of the Policy Spending Rate

Recorded Webinars to Empower your Leaders

- Basics of Planned Giving for Parish Leaders
- Basics of Endowment Management for Parish Leaders
- Prospective Donors of Planned Gifts
- Basics of a Capital Campaign
- Annual Stewardship
- Vestry Leadership 101

For links to recordings visit: www.ecfvp.org



Upcoming Free Live Webinars

- **Strategic Thinking for Congregations**
 - April 23, 2015 – 7:00 PM – 8:00 PM Eastern Time
- **Planning and Recruiting for Stewardship**
 - May 6, 2015– 7:30 PM – 8:30 PM Eastern Time
- **Lessons for all churches from Church Planting**
 - May 19, 2015– 7:00 PM – 8:00 PM Eastern Time
- **Legacy Societies and your Planned Giving Ministry**
 - June 3, 2015– 7:00 PM – 8:00 PM Eastern Time

Check our website, under Events, for more info.





At your service

ECF always available to assist at (800) 697-2858

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