

## 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](http://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 January 2013:

70/30 Equities/Fixed Income – 5.95% annualized over three years

60/40 Equities/Fixed Income – 5.35% 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>5.95%</u> | <u>5.95%</u> | <u>5.95%</u> |
| Difference               | (2.05%)      | (1.05%)      | (0.05%)      |

## ECF Pooled Fund Performance

As of December 2013 and Trailing Time Periods

|                                  | 1 Year | 3 Years | 5 Years | 10 Years | Since '98 |
|----------------------------------|--------|---------|---------|----------|-----------|
| <b>ECF INCOME FUND</b>           |        |         |         |          |           |
| Total Segment                    | (0.98) | 2.79    | 3.52    | 4.17     | 4.97      |
| Custom Benchmark                 | (1.22) | 2.89    | 3.98    | 4.04     | 4.82      |
| <b>ECF BALANCED FUND (50/50)</b> |        |         |         |          |           |
| Total Segment                    | 12.42  | 7.51    | 10.23   | 5.88     | 5.49      |
| Custom Benchmark                 | 11.96  | 7.68    | 10.62   | 6.12     | 6.13      |
| <b>ECF GROWTH FUND</b>           |        |         |         |          |           |
| Total Segment                    | 27.31  | 11.92   | 16.51   | 7.58     | 6.01      |
| Custom Benchmark                 | 26.68  | 12.36   | 17.17   | 8.20     | 7.45      |

## 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](http://www.ecfvp.org)



## Upcoming Free Live Webinars

- **Vision & Planning**
  - May 8, 2014 – 7:00 PM – 8:00 PM Eastern Time
- **Basics of a Capital Campaign**
  - May 14, 2014 – 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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