

## DISTRIBUTION & INVESTMENT PRACTICES: WHAT'S RIGHT FOR YOUR ENDOWMENT FUND?

Many churches today have established endowment funds that respond to the changing life of the congregation. These funds are typically created in support of the congregation's ministries and outreach programs and are vital to their future. But in order to maintain this future support, guidelines dictating how distributions are made from the fund and how gifts are invested may need to be revisited.

As a result of recent market volatility, many endowment fund committees are re-examining the specific language of their bylaws. In cases where hands are tied with restrictions of spending only income, some are amending bylaws to allow for more flexibility – flexibility that permits distributions when fund investments aren't producing income.

### **DISTRIBUTIONS FROM ENDOWMENT FUNDS**

How much an endowment fund distributes each year is typically dictated by congregational bylaws, and is often calculated using one of two methods:

**Income only.** This method refers to distributions made from income only. Using this practice, the congregation invests the dollars and distributes interest income. Sometimes there is a direct prohibition in the bylaws against distributing principal from the endowment fund. There are also times when donors to the endowment fund restrict expenditure of their gifts' principal.

**Designated percentage.** Another method that has quickly grown in popularity specifies a designated percentage of the fund's assets for distribution each year. This distribution method disregards traditional notions of income and principal as they relate to assets held in the endowment fund. The distribution percentage is typically 5-6%, and the amount distributed varies from year to year as the assets fluctuate in value. Because this method looks beyond the income earned by the fund assets, it permits distribution each year regardless of fund performance and sets the priority of distributing funds to meet the endowment fund's mission, rather than of preserving principal. Of course, when the market recovers, the principal will begin to rebuild.

### **ALIGNING YOUR INVESTMENT MIX**

When building investment portfolios for endowment funds, it makes sense that investments should be aligned to support the distribution policy. While simply stated, implementing an "income only" investment strategy gets sticky when you factor in the following:

- Modern investment theory has changed its focus to one of total return, rather than strictly income production.
- Many growth investment assets produce little or no income.
- Investing strictly to produce income doesn't incorporate diversification or encourage growth of the endowment fund.

Let's say that your distribution policy permits distributions to be made only from income. If your investment mix includes stocks for growth, there may be years in which there is little income generated despite growth in the value of the assets through capital appreciation. Even though the fund is doing well, by definition you may not be permitted to make any distributions to support your programs.

In contrast, a policy that calls for a specified percentage of the value of the fund assets permits annual distributions regardless of the types of investments held in the endowment fund. Generally, the growth in the fund is expected to be greater than the distribution percentage from the endowment fund. It provides a buffer against less favorable years, as well as inflation, and ensures that a distribution can be made each year. In prosperous years, the fund grows, allowing larger distributions to be made in subsequent years. This policy also allows for continuing distributions to be made in down years when distributions are often needed the most.

And just as the types of investments need to complement the endowment fund's distribution method, the timing of when distributions will be made also needs to be factored into the investment mix.

#### **DETERMINING THE RIGHT DISTRIBUTION METHOD AND INVESTMENT MIX**

Have you reviewed the bylaws that shape how you make distributions from your endowment fund? Is your method for distributions aligned with your fund's investments? And most importantly, are the distribution method and investment mix consistent with the objectives of your endowment fund? These three questions can serve as a starting point for discussion on what's best for your congregation's endowment fund. The outcome may result in updated investment and distribution practices that can enhance the future impact of your endowment fund.

#### **ENDOWMENT FUNDS AT THE LUTHERAN COMMUNITY FOUNDATION**

The Lutheran Community Foundation can distribute either specific dollar amounts requested by the congregation or organization, or a percentage of the endowment fund's value. Given the structure of Foundation investments, we are unable to calculate and provide endowment fund committees with "income only" amounts as may be dictated by some endowment fund bylaws. For more information about endowment funds at the Lutheran Community Foundation, call 1-800-365-4172 or visit our website, [www.TheLCF.org](http://www.TheLCF.org).