

## THE LAW OF UNINTENDED CONSEQUENCES



Just saying the word endowment can conjure up all sorts of possibilities, often causing problems for the volunteer trustee, finance committee or administrative council. Most of the issues relating to endowments arise out of the “law of unintended consequences”. The first of these issues is confusion over what an endowment actually is. The term endowment generally refers to funds that are designated by a donor or the “institution” for the long-term use by the church. There are, in fact, three types of endowments and trustees need to know the difference:

### 1. THE TRUE ENDOWMENT

The true endowment is a permanent fund established by a donor, the court, or another authority such as a foundation. A true endowment would be as follows: a bequest is made from Mr. & Mrs. Dunworkin where their Will states that only the income can be used. When the donor leaves the decision of how to spend the income up to the church, the fund is considered unrestricted. The church can use unrestricted income for any purpose. However, with a restricted endowment, the donor may restrict the income to be used for a specific purpose such as mission outreach, organ fund, etc. Once accepted by the Charge Conference the only way to change a restriction is to ask the donor, if living, or petition the court.

### 2. THE TERM ENDOWMENT

As the name suggests, the term endowment is a gift that is restricted for a specific period of time. For instance, Jane Donewell wants to supply seed money for a new ministry. She makes a gift that requires the principal to remain intact, and the income to be used for that new ministry only, for a period of ten years. After ten years Jane states that the church will receive the principal outright. The church can spend the principal or designate it to a quasi-endowment.

### 3. THE QUASI-ENDOWMENT

The church/institution may designate a gift or other funds to a quasi-endowment. The church

can use just the income if it chooses, or use the principal at a later date. Because the church/institution designated the gift for income only, they have the power to un-designate the gift as well. Let's look at a common example of the quasi-endowment. The UMC of Tamworth receives a \$100,000 bequest from Edith Bunker with no strings attached. Per the church endowment policy all bequests and planned gifts will be invested in the church endowment. The church would designate this gift as the Edith Bunker Fund and would be able to use the income for any purpose. If the church heating system failed and a new system would cost \$30,000, they could use \$30,000 from the Edith Bunker endowment.

Churches that have lost records of which funds were donor restricted or which ones were designated by the church to be quasi-endowments, find themselves even more confused when someone thinks that the Edith Bunker Fund is to be used for music only, because we all know Edith loved to sing. Not to mention that in 1985, someone commingled all the endowments so that they could be invested in a mutual fund and would receive just one statement instead of five. Here the "law of unintended consequences" has evolved into "Murphy's Law" where things go from bad to worse.

The second issue that arises from the "law of unintended consequences" is taking a short-term view of a long-term need. The management of church operating funds requires an investment in short-term instruments, such checking and money market accounts. However, endowments require a long-term view, balancing the need for long-term growth for future ministry and current income for today's programs. All too often investment decisions concerning endowments are viewed through a short-term lens. The recent market decline and rebound has influenced many investors to run for safety and sharpen their focus on the short-term.

But what happens when the long-term view is taken, lets say in twenty-year segments, with the worst-case scenario that uses actual historical returns that include 2009? According to an article by Dana Anspach<sup>1</sup>, the worse twenty-year period ended February 2009 recording an average return of 7%. Not bad, given that most advisors look for the stock market to return an average of 10% in the long-term, and it is certainly better than current CD rates. If you are wondering, the best period that ended in March 2000, saw an average of 18% . The consequence of investing long-term endowment funds in short-term vehicles is that you sacrifice growth over perceived safety. The principal here is only perceived to be safe, but inflation steals in and erodes the purchasing power of funds left in a CD or savings account. Many readers can recall their last car costing more than their first house and even younger readers can remember gas at 89cents/gal.

### ***To measure risk you have to account for time and inflation***

The only remedy to the "law of unintended consequences" is to be **intentional** about your endowment program, and getting a handle on that **now** is a good New Year's Resolution.

<sup>1</sup>www.About.com, Money Over 55, article titled "S&P 500 Index Rolling Stock Market Returns" by Dana Anspach