Background and Perspective on the Endowment Loan
December 29, 2016

Introduction

As a 1U member, you are also a member of a separate, non-profit corporation registered as The First Unitarian Church of Orlando Endowment Fund, Inc. Its mission is “to receive and manage financial gifts in order to generate and give, in perpetuity, funds to support and sustain the First Unitarian Church of Orlando as a liberal hub providing lifelong spiritual growth and compassionate services to the Central Florida community”. It is governed by a board (referred to as Endowment Board or EB) of six trustees whom you elect.

The EB manages about $780,000 in financial assets according to the wishes of donors and the requirements of the law. It normally allocates 30% of its assets to fixed income and 70% to equity mutual funds. That mix is expected to allow a distribution of 4-5% ($34,400 in the current year) to the 1U operating budget each year and still maintain the purchasing power of the donated corpus.

To help finance the campus renovation, the EB has offered to make an investment capped at $525,000 (about 67% of its assets) in the form of a loan to 1U. To inform your vote on the Building the Dream campus renovation project, the EB offers the following background and lender’s perspective on this investment. The numbers used in this discussion are representative; actual numbers may vary and market returns are estimated as long-term averages.

Background

Purpose of the Loan: The loan would provide $326,000 to cover the gap between money pledged/raised and project budget. 1U’s operating budget is projected to have annual deficits until 2025 and the remaining $199,000 balance of the loan would cover all or part of the loan payments until then.

Original Plan: It was believed that initial financing would be provided by an amortized loan from First Green Bank, (believed to be the most motivated project lender) and a supplementary interest-only loan from the Endowment. However, the First Green imposed a troublesome condition: in addition to holding a mortgage on the entire 1U property they required that the Endowment guarantee repayment of the entire loan. In the EB’s view the bank would get all of the financial reward and the Endowment would take all of the financial risk. This circumstance led to a search for a more equitable alternative.

Current Plan: The Endowment would be the primary lender, offering an unsecured loan that is capped at $525,000, has an interest rate of 4.5%, a term of 25 years, and is fully amortized except for the first two years which are interest-only. Annual loan repayment (debt service) is about $37,000, except for the interest-only period when it is about $24,000. The interest rate was chosen to provide a total portfolio return of 4-5% plus inflation (estimated at 1.5%) in order to enable the Endowment to continue the current level ($34,400 or 4.3%) annual distribution to 1U. A higher rate would raise 1U’s loan costs (annual payments), while a lower rate would reduce its income (annual Endowment distributions).

---

1 A long term inflation rate of 1.5% was used representing the approximate difference between treasuries and TIPS at the 20-25 year mark and is considered by some (e.g., Schwab) to be a reasonable basis for inflation estimates over that period.
Perspective

Legal Requirements: The Florida Uniform Prudent Management of Institutional Funds Act requires trustees to apply sound money management practices and identifies specific elements that they must consider when investing. Among these elements are: consideration of economic conditions, possible effect of inflation, the role of the investment in the overall portfolio, the expected total return, the needs of the endowment to make distributions and preserve capital, and, the asset’s special relationship, if any, to the endowment’s charitable purposes.

Assessment: The EB has assessed the proposed loan with regard to these criteria. The EB has believed from the start that campus renovation was necessary for the furtherance of 1U’s mission. While it did not seek to become the primary lender to the project, it believes that, compared to the alternative offered by the bank, its role as such is in the best interest of 1U and is consonant with the Endowment’s mission. As noted earlier, the interest rate on the loan has been selected to maintain the Endowment’s expected total return at a level that should continue to provide the customary annual distribution to 1U while preserving capital.

A more difficult aspect of loan is its impact on the Endowment’s diversity. The normal 30% fixed income portion of the Endowment’s portfolio is invested in an index mutual fund that holds 10,000 bonds, mostly US government securities. With the proposed loan, the fixed income allocation grows to 67% initially, with no diversity. Thus, 1U’s ability to repay the loan is paramount and is assessed as follows.

The EB notes that 1U has excellent credit (with no outstanding debt) and demonstrated its ability to successfully repay the $150,000 Endowment loan that it received to help finance the Sanctuary. (At the time that the Sanctuary loan was made, that loan also represented a large portion of the Endowment’s assets.) The EB considers 1U’s approach to the renovation to be fiscally conservative, disciplined, and sound. The EB views 1U’s 10-year financial plan to be thoughtfully constructed and sound and observes that the annual $37,000 loan repayment on the loan is a sustainable 7.5% of 1U’s operating budget. To help ensure that sound financial practices continue, the EB requires, via the Loan Agreement, that a permanent 1U Finance Committee with one EB trustee serving as a voting member be installed and active for the 25-year life of the loan. Finally, because Endowment membership and 1U membership are identical and the loan would make the 1U budget and Endowment Fund interdependent, there would be a strong common interest, motivation, and sense of obligation to fulfill the terms of the loan. In consideration of the above, the reduction in diversity is deemed acceptable.

Conclusion: Overall, the investment is judged to be a prudent one for the Endowment.

Respectfully,

The Endowment Board

Al Wileden, President; Steph Garber, VP; Diane P Kerkhoff, Secretary; Mike Haddad, Treasurer; Mary Dipboye, Trustee; Jean Siegfried, Trustee

---

2 Over time, as the principal is paid down, the loan becomes a smaller and smaller percentage of the total portfolio and diversity again increases.