

Financial Advisor's Report to the 1998 UUA General Assembly

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"Those of us who serve volunteer organizations, even if we have fiscal awareness, cannot reach to the heart of finances. The treasurer usually represents management. What we need is a person who strives mightily (not always successfully) to give us an independent and critical view - the best assurance available that we are being responsible...The Financial Advisor must take that role as central."

-Advice from a long-time UU leader in 1996

It is my pleasure to submit to you my first annual report. The Financial Advisor is elected by the General Assembly to serve as your best assurance that the UUA is behaving in a fiscally responsible manner. The Financial Advisor provides the President, Board of Trustees, & General Assembly with an *independent* and *expert* evaluation of financial issues and the fiscal health of the UUA, and the Financial Advisor recommends changes that will improve the quality of fiscal planning and management of the UUA

These responsibilities are carried out in *the public arena* of committees, boards and assemblies. They are also conducted *behind the scenes* in private conversations with the UUA administration and individual leaders. The public arena is particularly important for UUA trustees and General Assembly delegates in the fulfilling your fiduciary responsibility. The private sphere is equally important, where most concerns are resolved and more risks are taken in examining ideas and options.

My own approach to financial planning and management is outlined in the "Standards for Financial Performance" which I gave to the Board of Trustees just prior to my election in June, 1997 and which is attached at the end of this report. That approach is a result of both my professional experience and my denominational service*.

*[Professional experience includes service as Director of Budget & Financial Planning for Harvard University, Chief Financial Officer of the Woods Hole Oceanographic Institution, and Dean of Administration of Tufts University, as well as service as a board member and financial consultant for other nonprofit organizations. Denominational experience includes service as a member of the Commission on Appraisal and the Connecticut Valley District Board, as a board member and treasurer of the Church of the Larger Fellowship, and as a former President of Liberal Religious Youth (predecessor of YRUU)]

This is a wonderful time to be the Financial Advisor of the Association. There is energy and excitement throughout our growing movement. As a result, membership and revenues are growing. Most so-called "mainline" denominations have been shrinking for thirty years. Unitarian Universalists are not debating how to cut back. We are debating how to allocate growing resources to sustain our growth.

For a Financial Advisor, who is elected to be the skeptic, the challenge is to avoid complacency, and to remember that my job is to worry and warn. It is in good times that we are most likely to get overly optimistic, and over extended.

UUA Financial Monitor

I have created the UUA Financial Monitor to be a brief, simple presentation of the most important indicators, over time, of the financial health of the Association. It is included as an attachment at the end of this report. It will be updated and reissued annually. The UUA Financial Monitor shows the following changes since 1985:

- Growth in membership of 9%
- Growth in RE enrollment of 55%
- Growth in the number of congregations of 2%.
- Growth in total congregational expenditures of 112%
- Growth in total UUA annual fundraising of 98%
- Growth in per capita giving to the UUA (both APF & Friends) of 134%

Completion of the Capital Campaign

The \$10.2 million capital campaign was completed successfully this past year. The most important good news is not that we raised a specific dollar amount, but rather that we have succeeded in establishing what I call a "culture of philanthropy". There are two essential aspects to this culture:

- First, a new constituency of generous friends of the Association who are committed to providing resources to assure its future.
- Second, the ongoing expectation that the UUA administration is obligated, as a major priority, to sustain high levels of individual giving to the Association.

I am a very strong believer in perpetual capital campaigns, with only the label changing from time to time. Our record of ever-increasing levels of total gifts to the Association as a major achievement we must be diligent to sustain.

Endowment Performance

During the first part of this decade, the UUA's endowment performance was not very good. In spite of the best efforts of an experienced and dedicated Investment Committee, the UUA's Pool B (the endowment that supports the UUA's operations) under-performed most nonprofit endowments to a significant degree. The reasons for the under-performance were: an imprudent aversion to volatility (changes up and down in the short run), constant changing of investment strategy (never allowing any one strategy enough time to work), and an asset allocation that put too much of the endowment in types of investments (bonds, cash) that historically perform poorly relative to stocks.

This past year, there is excellent news to report for Pool B. For FY97, the total return was 20%, a figure on a par with other nonprofit endowments and with weighted market indices. (The total market value of Pool B on June 30, 1997 was \$68.9M). This extraordinary improvement is the result of the Investment Committee's decision in 1995 to change strategy and managers, and to stick with those changes until they had the opportunity to show sustained, good results. The committee, and particularly its chair Robert Sarly, is to be praised for its actions, and for its determination to stick to those actions.

The Investment Committee is rightly concerned about the high level of spending from Pool C, which is the endowment fund operated for congregations and affiliated organizations and supervised by the Investment Committee. The current spending rate is 5.5%. It is likely that the Committee will recommend a lower spending rate at some point in the future. Let me briefly mention why a lower spending rate is important. Spending rates are established to achieve two goals simultaneously:

- First, to preserve the after-inflation value of the endowment for future generations, and
- Second, to provide a predictable income stream to support present operations.

A spending rate that is too low sacrifices the present to the benefit of the future; a rate that is too high sacrifices the future to the benefit of the present. A good compromise between the present and the future is generally between 4.5% and 5%. That range is the result of the following thinking: on average in this century investment returns have been 10% per year while inflation has averaged 5%. Subtract the inflation from the returns and you get 5% per year to spend while preserving the after-inflation value of the endowment.

FY97 Operating Results

The audited financial results for FY97 were very positive . The budget was balanced at year end when revenue and expense are defined as we do for the operating budget. Indeed, we had a modest \$55,000 surplus on revenues of \$18.9 million, as shown in the Financial Monitor (at the lower right hand corner).

Our audited financial results (as well as our budget figures) have become difficult to interpret. That's because of two separate positive developments that are occurring simultaneously:

First, new accounting regulations are taking effect, and in phases over several years. Familiar formats have been discarded, and new ones introduced that don't easily compare with past ones. We now report as "assets" to the association items that were not counted at all in the past, such as the discounted value of pledges. Our operating budget cannot be neatly tied to the audited financial report because of all of the accounting changes. This is not unique to the UUA; it is common to almost all non-profits (and all complex ones.).

Second, we are bringing all of the UUA's funds into its budget and financial reporting systems, to show all of the UUA's available resources and their use. That also is occurring over several years, and creates the illusion that the UUA's resources are growing faster than they are.

Let me offer an example of the latter situation. The FY97 audited financial report shows (p. 2) that the net assets of the UUA have increased from \$113M to \$163M from FY96 to FY97, an increase of \$50M. However, \$37M of that increase is the result of the placing of various trusts (primarily Holdeen) into the financial statements for the first time. The remainder of the increase in assets is real, and reflects primarily the increase in the market value of the endowment and the discounted value of pledges to the capital campaign.

In reporting to your congregation you can say that the FY97 budget was balanced and that we saw a real increase in net assets of \$13M thanks to excellent endowment performance and the success of the capital campaign.

I share the concern of Arnold Bradburd, the previous Financial Advisor, about the tardiness of the audit report. The Board reviewed that report almost seven months after the close of the fiscal year. To exercise its fiduciary responsibility, the board should review the prior year's activity at its October meeting. The administration, in cooperation with our auditors, has a plan to achieve that objective for the close of FY98.

FY98 Operating Budget

The October 1997 Board meeting approved the revised and updated FY98 operating budget (the original FY98 operating budget was approved in October 1996). There is good news in this budget from a financial perspective.

First, as mentioned earlier, funds previously "off line" have been placed into the operating budget directly, where we can see them.

One unfortunate but necessary result of this positive change is that the budget of the Association appears to have grown substantially from FY97, since the FY97 numbers are not restated to be consistent with FY98. (It would take too much staff time to restate them for the prior years.) It appears that the budget has grown by 11.9%, but that is because \$1.5M has been added to FY98 but is not reflected at all in FY97. If we were really comparing apples to apples, the real budget growth would be 3.1%.

Second, there is greater clarity in financial reporting (and thus accountability): the budget distinguishes clearly between income for general support and income for designated purposes; and provides greater detail in expenditure categories.

With respect to the budget, there are two areas where the UUA could improve its practices:

First, the administration, in submitting its proposed operating budget to the Board of Trustees each year, should include a narrative that describes the major policy and program objectives, and especially the tradeoffs needed to achieve those objectives. Such a narrative, particularly if mailed to the board well in advance of its meetings, will significantly improve the board's ability to understand and evaluate the budget prior to its approval.

Second, the budget should truly reflect current priorities, rather past priorities. Like most organizations the UUA practices what is known as "incremental" budgeting, in which new programs are added but current programs are rarely deleted. I joke that this practice assumes that every current program is more important than any future program. If we are to escape this easy trap, we need to create a budget "from scratch," perhaps at least once every four years.

In response to that observation, the administration notes that it does make changes in staff position responsibilities and occasionally reorganizes. Those are important actions that assure responsiveness to changing circumstances, but they may be changes "at the margin" rather than significant re-creations of organizational and financial patterns to meet current needs and priorities.

FY98 Year to Date

A careful review of the year to date actuals, and of likely variances predicted by the administration, indicates that we are likely to end FY98 in balance.

41 Mt. Vernon Street Acquisition and Financing

The acquisition and financing of 41 Mount Vernon Street is largely complete and with limited financial risk to the Association. Programmatically, the result is more functional and accessible space for the UUA and particularly for Beacon Press. To make the acquisition, the UUA sold less desirable space at 53 Beacon Street.

Throughout the decision making process, the Board of Trustees has been very careful to fulfill its fiduciary responsibility. We have reviewed each transaction, and asked that the administration prepare analyses showing the financial effects of various options and contingencies. The Board has approved each transaction with its eyes wide open, fully aware of the rewards and risks.

Financially, the net effect of the sale of 53 Beacon Street and the acquisition and renovation of 41 Mount Vernon Street is an additional debt principal for the UUA of approximately \$1.5 million. Payments on this debt are not an immediate problem, because the UUA received, from the Liberal Religious Charitable Society, a promise to provide \$300,000 a year for two years and \$150,000 a year for an additional two years, to help cover the costs of this important initiative. However, renovation and maintenance costs may exceed estimates, and the LRCS subsidy will decline (and disappear) over

time. So it is very important that the administration monitor its costs closely and utilize all unrestricted resources to reduce the debt service.

Beacon Press

In the past, Beacon Press has sometimes brought bad fiscal news. There is some good news now. The FY97 results were better than expected (i.e. a smaller deficit), because of a rebound in paperback backlist sales and a decrease in returns from the prior year. The increase in paperback backlist sales is particularly encouraging because, if sustained, it means that the Press can rely less on individual blockbuster books. The Press has a new distributor, with a better fulfillment system, wider market penetration, and a sophisticated marketing data system. And the FY98 projected deficit of \$65K is less than the FY97 deficit, although it represents a deterioration from the break-even budget originally planned.

Beacon Press has prepared a five year business plan which it shared, on a preliminary basis, with the Finance Committee of the Board and with the Beacon Press Advisory Board.

Finance Department Staffing

Good management depends on professional financial staff in sufficient numbers to assure that all important tasks receive the attention they need. The UUA's budgeted staffing level has not been adequate in the past. In addition, there have recently been vacancies that could have jeopardized our ability to provide good financial reporting to management and services to the congregations. I'm pleased to report that, in the past year, the UUA has increased its budgeted staffing level by one, adding the needed position of Manager of Financial Reporting. And all of its vacant positions have been filled.

Congregational Properties Loan Commission

Starting in February 1997, the Congregational Properties Loan Commission was able to make loans of up to \$500,000 "at competitive rates to qualified congregations," in addition to the loan guarantee program that the Commission has been offering in recent years. The new loan program was a response to market conditions that reportedly made it difficult for congregations to obtain loans from their local banks.

By the time the new loan program was offered, market conditions changed and congregations are finding it much easier to obtain financing from banks. As a result, the loan guarantee program thrives, with total volume exceeding \$3M. At the same time, the CPLC has received only a few requests under the "new" loan program.

We don't really need to worry about the lack of current enthusiasm for our new program: it is important only that congregations have access to financing that they can afford; and they do. Now they have two alternative options from the UUA, rather than the "one size fits all" program that we offered previously.

The Congregational Properties Loan Commission is reviewing a set of proposed guidelines for a site acquisition program to accelerate the process of new congregations acquiring appropriate facilities (land, construction, or purchase) that will sustain and encourage further growth.

The Commission is also looking closely at the idea of recommending a set of guidelines for congregations about the appropriate types of insurance coverage. It is likely that many congregations do not have adequate insurance coverage: for replacement costs, new code provisions, workers compensation, casualty, error or omission liability, sexual misconduct, employee practices, and clergy counseling, as examples. In addition, many congregations have not planned adequately for insurance coverages for various social services such as day care centers and homeless shelters.

Church Staff Pensions

The Committee on Compensation, Benefits & Pension has recommended a new investment manager for the fixed income portion of the pension and begun to examine having a single administrator for the pension. The total pension is about \$88 million. The investment performance of the pension fund has been very good.

At its October 1997 meeting the Board adopted a recommendation to change the manager of the fixed income portion of the pension fund (\$19.7M). This portion of the fund is more accurately labeled "stable" income, since it is chosen by participants who want to avoid fluctuations in their income over time. Its stated goals are preservation of principal and stability of income. The previous investment vehicle used to provide that type of pension was not sufficiently diversified in its investments to assure the safety of principal (and thus, eventually, income) that is required. The new manager is T. Rowe Price, a firm with an excellent management structure in place and a fine record of both investment performance and client service.

Church Staff Compensation

A program to improve church staff compensation was approved by the 1995 General Assembly. Much effort has been made by many good people to make that program a success. Results have been uneven, however, with great progress in some districts and limited activity in others.

The effort to improve church staff compensation was not receiving the priority and attention that it needed to be truly effective.

This spring, intensified idea gathering and planning has occurred, involving the Board's Working Group on Ministry, the Committee on Compensation, Benefits & Pension, representatives of the UUMA, LREDA, the Council on Church Staff Finances and several UUA departments. One result is the high profile this issue now enjoys. A second result is the excellent summary of ideas reviewed and approved, in principle, by the Board of Trustees at its April meeting and endorsed, again in principle, by the

administration. A third result worth noting is the willingness of the UUMA to increase its already substantial financial commitment to the success of the effort.

The administration has made a commitment to present to the Board, at its June 25 meeting, a detailed, implementable plan for improving church staff compensation, with the expectation that the plan can be announced at the General Assembly.

For me, there are several lessons I have learned in the past few months:

- First, the issue must be framed as a moral imperative, a justice issue just like issues such as accessibility. We must steer our low-paying congregations away from justifying their practices based on the marketplace.
- Second, the effort at transformation must be lay led. It only carries moral authority under those circumstances.
- Third, success depends on everyone putting their shoulders to the wheel. The ownership of the program must include all levels of the denomination and each of the departments of the UUA that can help make it a success, not only the Ministry Department but also communications and publications, congregational and district services, and religious education.

So now we have renewed commitment and momentum, which we must all be vigilant to sustain.

Just as one way to stress the importance of this issue, let me share with you part of a draft report on the demographics of the participants in the UUA Pension Plan, prepared by Sheldon Bennett, the chair of the Council on Church Staff Finances:

"Of the 268 ministers age 45-54 in the UUA plan, 100 (37%) have accumulated assets of less than \$25,000. A minister age 50 with less than \$25,000 accumulated assets will be hard pressed to accumulate a total of \$100,000 by age 65. And 131 ministers in this age bracket are not in the plan at all (33%). Note: \$100,000 at retirement would pay out approximately \$6000 to \$9,000 per year depending on how it was invested, life expectancy, etc.

Of the 192 ministers age 55-64 in the UUA plan, 113 (59%) have accumulated assets of less than \$75,000. A minister age 60 with \$50,000 assets will be hard pressed to accumulate a total of \$100,000 by age 65, and their success will depend more strongly on it being a favorable market cycle for those five years.

Of the 136 age 65 and older in the UUA plan, 79 (58%) have accumulated assets of less than \$100,000.

Although some ministers are managing to accumulate adequate assets to assure a comfortable retirement income, a majority of ministers in the plan age 45 and over will face financial hardship in retirement if the UUA plan and Social Security are their only sources of income.

Education and plan promotion must be emphasized. Ministerial aid and sustentation support for ministers in retirement is going to be the reality for decades to come. This will be even more the case given the high levels of indebtedness of many new ministers."

Conclusion

In conclusion, on the positive side of the ledger:

- we have completed a successful capital campaign; and the fundraising effort will continue
- we ended FY97 in the black and are likely to end FY98 in the black
- the investment performance of both the endowment and the pension were excellent in FY97
- Beacon Press ended FY97 with a smaller deficit than planned and will end FY98 with a smaller deficit than FY97
- the FY98 and FY99 budgets (as well as projections for FY00 and FY01) include more of the UUA's various funds than past budgets
- we have acquired 41 Mt. Vernon Street (and sold 53 Beacon Street), producing more and better space for the UUA at minimal financial risk or cost

On the negative side of the ledger:

- the audit of FY97 was late once again
- there is a risk that the 41 Mt. Vernon Street acquisition will negatively impact future operating budgets unless monitored and controlled closely
- the proposed budgets should have a narrative describing program and policy priorities and tradeoffs
- the proposed budgets should reflect current rather than past priorities
- the "spending rate" for Pool C (endowment managed for congregations) is too high
- The implementation of the renewed program to improve church staff compensation must be closely monitored.

The positives clearly outweigh the negatives, as I hope they always will. I have been very impressed, in my short tenure thus far, with the leadership of this administration and the stewardship of this board.

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UUA Financial Monitor

The UUA Financial Monitor provides the most important indicators needed to monitor the financial health of the Association over time. It is intended to be concise (no more than one page). Dollars reported are in 000s (except for #7). The Financial Monitor is the responsibility of Larry Ladd, UUA Financial Advisor.

Indicator	<u>1985</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>85 to 97</u>
Denomination										
1. Membership	139,227	145,250	147,256	148,182	139,157	142,157	147,940	150,513	151,213	9%
2. Religious Educ. Enrollment	39,009	48,161	50,228	52,417	54,796	N/A	54,796	58,716	60,384	55%
3. No. of Congregations	1,012	1,019	1,020	1,029	1,037	N/A	1,036	1,039	1,034	2%
4. Congregational Expenses	\$ 58,858	\$ 80,995	\$ 87,084	\$ 92,981	\$ 97,822	N/A	\$ 110,727	\$ 119,300	\$ 124,863	112%
5. UUA Expenses as % of Congregational Expenses	8.5%	8.6%	13.9%	14.6%	14.5%	N/A	14.3%	15.1%	15.1%	N/A
6. APF as % of Congregational Expenses	2.5%	3.0%	3.0%	3.0%	3.2%	N/A	3.1%	3.1%	3.2%	28%
7. APF&Friends Giving Per Member	\$13.77	\$21.07	\$22.63	\$24.22	\$27.42	\$28.14	\$28.32	\$31.83	\$32.19	134%
Financial Support										
8. APF Annual Revenue	\$ 1,465	\$ 2,392	\$ 2,620	\$ 2,817	\$ 3,106	\$ 3,269	\$ 3,450	\$ 3,756	\$ 3,979	172%
9. Friends of the UUA	452	669	713	772	710	731	740	1,035	889	97%
10. Gifts & Legacies	3,051	686	1,960	1,465	3,706	1,795	2,923	3,920	4,945	62%
11. Total Fundraising	\$ 4,968	\$ 3,747	\$ 5,293	\$ 5,054	\$ 7,522	\$ 5,795	\$ 7,113	\$ 8,711	\$ 9,813	98%
Resources										
14. Unrestricted Fund / Net Assets	\$ 3,823	\$ 3,104	\$ 2,182	\$ 2,512	\$ 4,913	\$ 4,960	\$ 7,189	\$ 7,156	\$ 6,154	61%
15. Endowment (Market Value)	\$ 38,245	\$ 52,282	\$ 59,217	\$ 61,970	\$ 59,333	\$ 57,078	\$ 71,764	\$ 75,526	\$ 89,399	134%
16. Endowment (Total Return)	14.3%	(1.9%)	12.8%	13.7%	10.0%	4.4%	12.1%	12.0%	20.6%	
Operations										
17. Operating Revenue & Support	\$ 4,811	\$ 7,071	\$ 12,061	\$ 13,892	\$ 15,323	\$ 15,873	\$ 15,133	\$ 18,013	\$ 18,887	293%
18. Operating Expenditures	5,015	6,993	12,122	13,562	14,225	15,825	15,783	\$ 17,979	\$ 18,834	276%
19. Operating Surplus (Deficit)	\$ (204)	\$ 78	\$ (60)	\$ 330	\$ 1,098	\$ 48	\$ (650)	\$ 34	\$ 55	