The Bondport file at the text website will help in the solution of the following church endowment fund case study. (This is an actual situation with the original market price data preserved.) In May 1990, Local Church had an endowment fund with a market value of about $750,000. This fund was managed by a bank trust department with a primary objective of growth of income and a secondary objective of income.

For calendar year 1990, the church had budgeted annual income of $54,600 from the endowment fund. Each month the bank forwarded a check for $4,550 (one-twelfth of the annual amount) to the church treasurer.

The church’s board of trustees had formed an investment advisory committee (IAC) in 1988 to oversee the management of the fund and to increase the regularity of communication between the bank and the church. Although the bank had made periodic presentations to the board of trustees, membership of this board changed annually. The IAC was intended to provide some constancy to the long-term administration of the endowment fund and regular communication between the bank and the church. The members of the IAC (all of whom were church member) were all investment professionals.

In May 1990, the LAC discussed the feasibility of withdrawing the fixed-income portion of the endowment fund from the bank trust account and managing this portion of the fund themselves. The IAC members clearly had the capability to do so, and it appeared that this move would save the church about $3,900 in annual management fees.

The LAC considered managing the equity portion of the fund as well, but several members were concerned about the lack of precedent within the church for assuming such a level of fiduciary responsibility. The consensus was that it would be better to go slowly and let the precedent of internal management of any part of the fund develop before dealing with the equity securities.

During the spring of 1990 the church was also in the final stages of selecting a new minister. The search committee found a very talented man from out of state who seemed the perfect candidate. Finding suitable, affordable housing for the minister, his wife, his four children, and his two horses turned out to be a problem. As a consequence, the board of trustees agreed to loan him $50,000 from the endowment fund at an 8% interest rate, with the interest accruing (no payments being made) for five-year period. This development, coupled with the anticipated savings from moving the fixed-income portion of the fund, led the IAC to recommend to the church’s board of trustees that the shift be made, and late in the year the funds were transferred to a custodial brokerage account at the stockbroker IAC member’s firm. The following table shows the composition of the fund on January 1, 1991.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Par | Bond | Coupon (%) | Maturity Date | Price |
| $25,000 | Ford Motor Credit | 8.875 | 5/15/94 | 104.375 |
| $40,000 | Virginia Electric & Power | 9.375 | 6/01/98 | 111 |
| $30,000 | Federal Home Loan Bank | 8.15 | 4/27/92 | 101.312 |
| $25,000 | Federal Home Loan Bank | 8.60 | 5/26/92 | 101.734 |
| $15,000 | Federal Home Loan Bank | 8.80 | 11/25/92 | 103.859 |
| $30,000 | Federal Home Loan Bank | 9.50 | 1/25/93 | 105.078 |
| $40,000 | Federal Home Loan Bank | 10.75 | 5/10/93 | 107.906 |
| $40,000 | U.S Treasury note | 8.00 | 7/15/94 | 107 |
| $20,000 | Federal Home Loan Bank | 8.875 | 6/26/95 | 110.281 |
| $50,000 | Federal National Mortgage Assn | 9.35 | 11/10/97 | 112.671 |
| $50,000 | Federal National Mortgage Assn | 9.55 | 11/10/97 | 115.469 |
| $30,000 | U.S Treasury note | 8.00 | 8/15/99 | 108.406 |

Mortgage: 54,000

Cash: 7,000

(Common stock $250,000, dividend yield 3.0%)

IAC knew that it would be occasionally be necessary to transfer funds from the equity portion of the fund (at the bank) to the fixed-income portion (at the brokerage firm). It was important to keep the number and size of these transfers to a minimum because of the importance of equity growth (and growth of dividends) to a growth-of-income objective. Because the cash receipts from the bonds and the cash disbursements to the church treasurer were both known, it appeared possible to find an appropriate, if not an optimum, transfer policy for funds from the brokerage firm.

Second, and of greater concern to the IAC, was the “lost income” from the $50,000 loaned to the minister. Although this interest continued to accrue, it was not currently payable and consequently could not be used to pay the bills. The 5% annual income growth rate meant that in 1992 the fund would be required to generate $60,196, and achieving this was going to require some advance planning.

**What instructions should be given to be the bank regarding the need for cash transfers, and how should the endowment fund be postured so as to generate the require $60,196 in 1992?**

**Then, in regards to this question, along with your financial calculations include an explanation for your answer.**