THE UNITED CHURCH OF CANADA
L'ÉGLISE UNIE DU CANADA

TOWARDS 2018 -2019

Background briefing for 2017 Budget and 2018 Outlook

Briefing Note to the General Council Executive, Spring 2017

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Background Briefing for 2017 Budget and 2018 Outlook

Executive Summary

This document is intended to serve as a high level primer on church finance and the decisions that will need to be made over the next few years at different levels of the church. It is written at a time when the outcome of remits is unknown, and clearly remit outcomes will drive the overall financial plan. We are however managing an overall trajectory of expense reduction to match declining revenues while we actively promote stewardship.

By both operating budget and financial statement measures, 2016 was a positive year. Expense savings and investment gains offset declines in revenue. Eight years of positive investment results coupled with expense management efforts has slowed the rate of unrestricted reserve depletion. While future projections continue to demonstrate the need for substantive change, we have good capacity to make those changes.

The audited church financial statements include elements that we actively budget and manage, but also elements that are more variable. For example, emergency appeal receipts and grants are excluded from our budgetary reporting. Similarly, KAIROS finances (approximately $2 million per year of revenue and expense) are consolidated on our financial statements to meet regulatory requirements, but a separate process applies. As we await the outcomes of the remit process, planning is underway to support the full range of possible outcomes and the need for ongoing savings. This includes contingency planning in partnership with our Conferences and a reduction of General Council Office space.

The 2017 operating budget does again project a substantial deficit. The recommended budget shows an operating deficit of $2.8 million before investment income and deficit of $2.0 on a net basis. This amount is deemed acceptable and is being recommended, because:

- We have adequate reserves to fund this;
- We need to retain some capacity to respond to remit outcomes
- There are clear savings identified for 2018 that would alone offset this deficit

2018 is expected to be a transition year in any case – irrespective of remit outcomes. If the remits are largely approved, we anticipate implementation to take effect in 2019 with considerable planning and coordination activity that will need to happen relatively quickly, i.e. setting new region boundaries. If the remits are largely not approved, each court will still need to respond to financial realities including elimination of conference operating grants.

In any case, we will be working together through a period of unprecedented structural change for the church. This will require much collaboration and trust between our courts that all are working towards a less bureaucratic and more mission focused church.

Overall Financial History and Context

The work of the church is funded primarily through regular offerings and other income in the congregations supplemented nationally by direct giving programs, investment and a small amount of external program-specific funding. Congregations are generally self-sufficient financially, and contribute to the work of Presbyteries and Conferences through payment of mandatory dues or assessments, and to the work of the national church through voluntary gifts to the Mission and Service Fund.

Over the last decade, all levels of the church have been increasingly using reserves to fund current operations. The total amount raised across the whole church was increasing about 2% per year through 2007 but has been declining since then. It is apparent that we have now reached the tipping point at all levels of the church where the growth in average gift per person no longer offsets the decline in total givers.

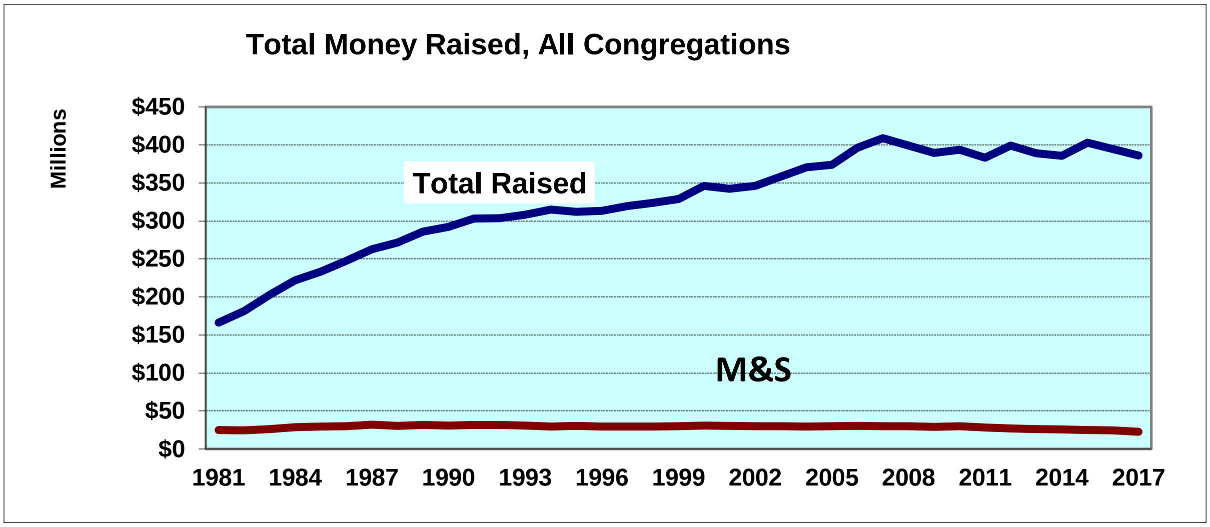

Figure 1

Figure 1 shows how much money is raised across the whole church compared to the Mission and Service Fund. The total amount raised in all the congregations moves up and down a bit with asset sales and bequests, but is generally in the range of $385 million with total giving now declining by 1-2% per year. Of this total raised, about $250 million now represents congregational giving and $135 million other sources of income such as building rentals, asset sales, investment income and local fundraising events. Congregation giving largely kept up with inflation until the last decade.

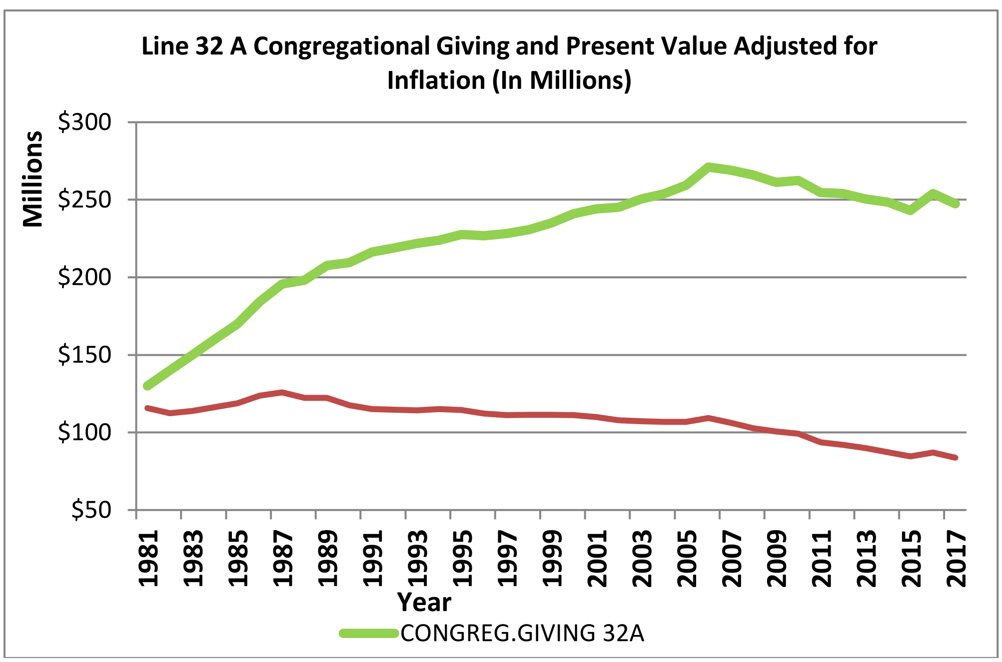

Figure 2

About $360 million or 93% of the total is used for work of the church locally and regionally, including assessment of approximately $10.5 million and about $24 million for the work of the General Council. While the amount raised for the work of the denomination through the Mission and Service Fund had remained virtually constant at $30 million for over 20 years through 2006, it has been slowly declining ever since, and it is now apparent that we must be planning for a decline in absolute dollars in addition to the ongoing erosion of purchasing power after inflation.

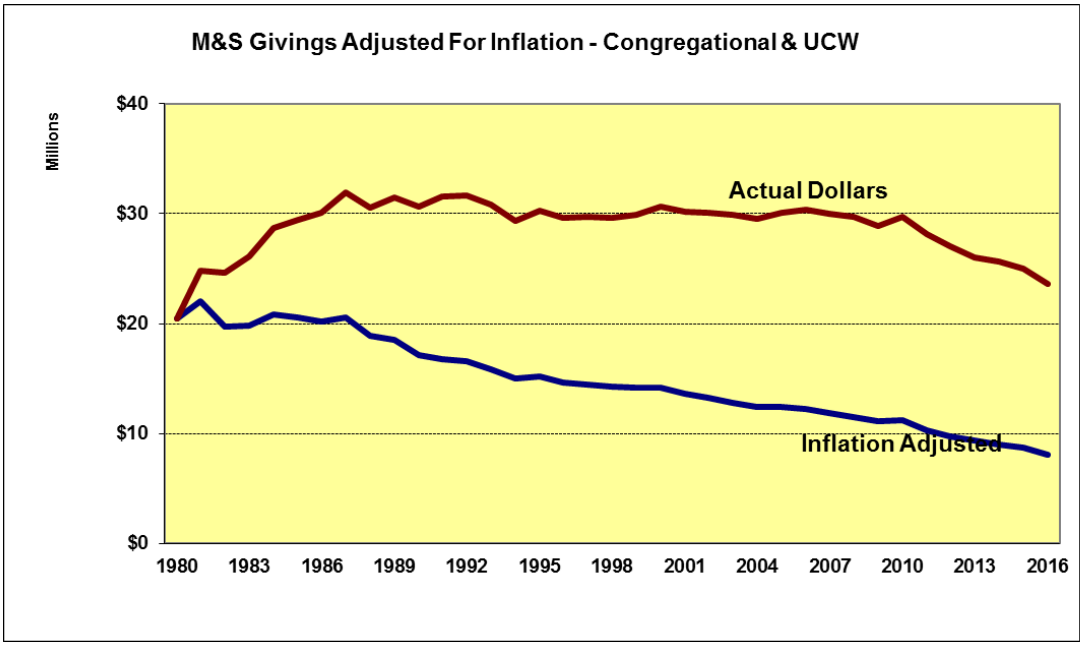

Figure 3

With cost of living adjustments the real capacity to do the work of the General Council has been reducing by about half a million dollars each year. Adjusted for inflation, the purchasing power of Mission and Service givings is less than half today what it was in 1980. More recently, Mission and Service giving in absolute dollars has begun to decline, with the trend perhaps more pronounced as more churches close.

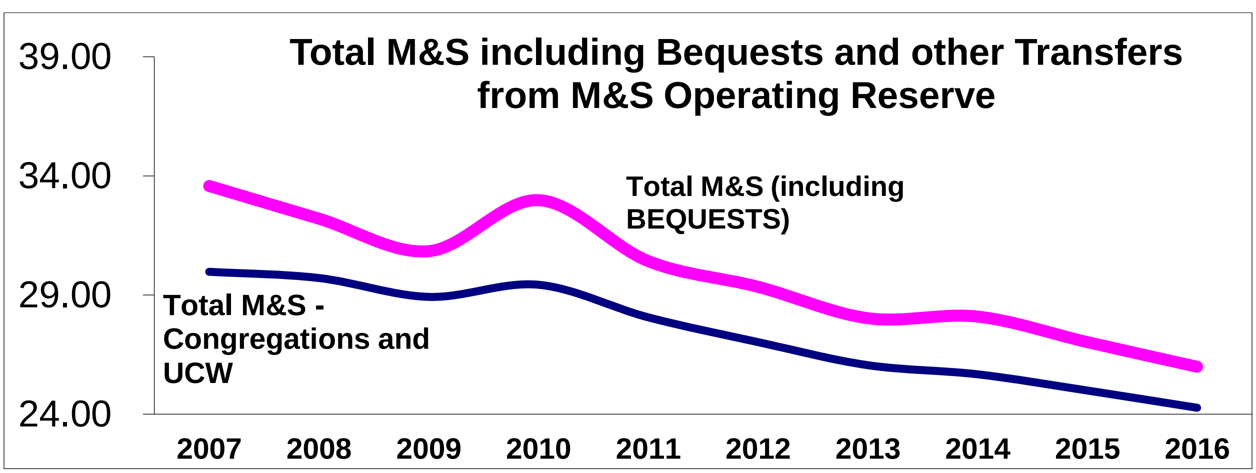

Figure 4

Many churches are experiencing numeric decline as their members' average age increases and attendance drops. With population shifts and an increasingly secular society, it seems inevitable that the church as we know it will continue to shrink before reaching a new equilibrium. It may not be possible to reverse the overall trend, but a concerted effort to rejuvenate existing congregations and create new ones is needed. In addition, new flexibility is needed in the definition of what constitutes a congregation. If we continue to define congregations in terms of Sunday morning worship in a stone building, we will miss large areas of potential growth of ministry. In financial terms, the seeds planted today will need time to grow to the point where they can contribute significantly to the money raised, but new ministries are a key way to reverse the gradual decline currently being experienced.

Work is ongoing to slow the trends of revenue decline:
In recent years, comprehensive resources for both congregational giving and Mission & Service giving based upon best practices and proven methods have been made available to support and enhance giving within current church populations. The major areas of potential that these programs are aimed at are to increase the quality and effectiveness of the giving programs and to increase participation in Mission & Service giving.

In addition to this and in alignment with patterns of giving across Canada we are seeing giving to specific areas of donor choice producing greater growth than giving to the unified fund. Most organizations have moved away from dependence on unified funds for growth revenue and actively explore donor wishes for choice in their giving. Future planning for Mission & Service giving includes the exploration of choice options to support this trend in donor preferences and also include the possibility post remit 4 of more clearly focusing Mission & Service as "Mission and Ministry"

In addition, programs and grants such as the Edge Network, Embracing The Spirit, New Ministries Grants and Seeds of Hope Grants are collectively focusing on innovation and development of thriving communities of faith which have the potential of positively improving the financial health and stability of those congregations and communities of faith.

The General Council Budget Context

A significant portion of the General Council budget helps support the whole church. For example, 11 out of 13 Conferences substantially depend on operating grant funds, and virtually all aboriginal ministry and right relations work is funded nationally. Among other things, this means that the congregations most supportive of M&S fund a disproportionate share of broader church shared services. Remit 4 proposes that congregational assessment fund all broader church work including national shared service work currently funded by M&S. Until recently, downsizing and expense reduction has been limited to the General Council Office while regional budgets and staffing actually grew. In 2013 the General Council Executive chose to cut conference operating grants in the same proportion as other national grant programs. A further more substantive cut was approved for 2016. The renewal proposals contemplate expense reduction across the whole church system. The financial modelling also includes an aspiration to maintain external grant programs at 2016 levels for several years – as opposed to the regular reductions we've seen over the last decade. <u>It is also important to note that expense reduction activity must be taken whether the various remits are approved or not</u>**.** Consequently, we anticipate conference operating grants will be eliminated by the end of 2018 – earlier in some cases. This will like necessitate regional downsizing and consolidation. It will also mean ongoing staff reduction at the General Council office. General Council Office staffing is already at 2/3 of what it was a decade ago and will be closer to ½ by 2018. While this takes place, we are committed to maintaining current levels of spending for aboriginal ministry and right relations. There have been a number of downsizing / restructuring initiatives undertaken to compensate for this decline in resources and resource purchasing power. A major restructuring was done in 2003 and there have been subsequent downsizing efforts in 2007 and 2010 and 2013. In 2013, 28 approved positions were eliminated at the General Council Office and grant reductions effected for a total of $5 million in cost reduction. Our 2016 Operating result included elimination of 8.5 approved positions without layoffs as this was achieved through attrition. (retirements, departures and re-organization).

The United Church of Canada
STAFFING PLAN (FULL TIME EQUIVALENT)/FINANCIAL

	2006 FTE	2007 FTE	2010 FTE	2011 FTE	2013 FTE	2014 FTE	2015 FTE	2016 FTE
Communities in Mission	12.0	20.5	21.5	22.5	30.8	27.0	25.6	26.1
Ministries in French (merged)	5.5	5.5						
Ethnic Ministries Council (merged)	6.0	6.0						
Support to Local Ministries (merged)	13.9	0.0						
JGER/Partners in Mission (merged)	24.0	19.5	19.5	19.0				
Finance	34.5	31.0	26.0	17.1	18.1	18.1	16.9	16.0
Information Technology (merged with Finance)	7.0	7.0						
Stewardship/Philanthropy	14.0	14.5	16.5	19.5	18.4	18.3	15.7	15.9
MEPS/Human Resources	11.0	13.0	15.7	15.6	13.5	13.5	12.9	11.7
Office of the Moderator and the General Secretary	22.0	19.0	15.5	21.6	11.2	10.7	18.3	22.3
Communications	41.0	33.0	34.5	31.2	28.6	29.1	25.7	18.7
The Edge				3.0	3.0	3.5	5.5	5.0
Emerging Spirit	5.0	5.0	5.0		--	--	--	--
Residential Schools/Right Relations	3.0	2.5	3.0	3.5	3.6	2.1	2.5	2.1
Healing Fund (merged with Circle)		1.5						
Aboriginal Ministries Circle			8.0	8.0	7.0	7.0	7.0	7.0
Sub Total - funded by M&S and unrestricted reserve	**198.9**	**178.0**	**165.2**	**161.0**	**134.1**	**129.2**	**130.0**	**124.8**
United Church Foundation					2.2	2.3	3.7	3.5
Payroll Service	0.5	0.5	0.5	0.5	0.5	0.5	1.0	1.3
Chaplains	3.0	3.0	3.0	4.0	7.0	1.0	--	--
General Insurance plan				0.9	0.9	0.9	0.9	0.9
Pension and Benefits	9.0	10.0	13.5	13.9	18.8	18.8	18.8	16.6
Sub Total - EXTERNALLY Funded	**12.5**	**13.5**	**17.0**	**19.3**	**29.4**	**23.5**	**24.4**	**22.3**
GRAND TOTAL	**211.4**	**191.5**	**182.2**	**180.3**	**163.5**	**152.7**	**154.4**	**147.1**

On a more positive note, these painful actions, coupled with a sustained period of positive investment returns has slowed our reserve depletion. We do anticipate some layoffs in at the General Council Office in 2017 and potentially more in 2018. Certainly the outcome of the remits will be a factor in determining scale, timing and areas impacted. More significantly, there will be significant changes for many of our Presbyteries and Conferences, as conference operating grants are phased out.

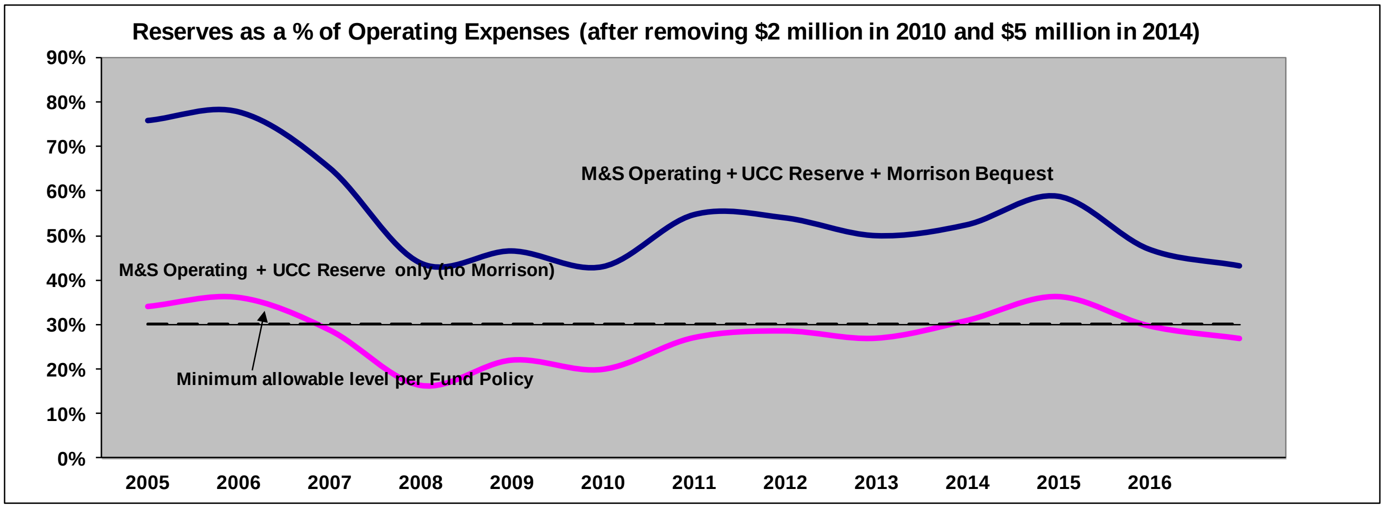

Figure 5

Five years ago, there was a significant risk that reserves would be completely depleted by now. Figure 5 shows that the expense reduction actions taken in 2010, 2013 and now 2016 – coupled with favourable investment returns and less erosion of M&S giving – have bought us some time and capacity to implement the more substantive restructuring contemplated by our remits. It is also important to note that had we not received the Morrison bequest in 2000 ($20 million), we would have had reached this "financial cliff" a decade ago.

Operations Overview

In the simplest terms the General Council financial operation goal can be described as:

Revenues + Reserves
= Grants + Staff + Program + Meetings & Travel + Operations

Revenues consist of:

- congregation, UCW and direct givings through the Mission and Service Fund (about $23.7 million in 2016) which is forecast to decline by $500,000 - 1,000,000 per year;
- bequests to the Mission and Service Fund (variable, but we average about $2 million per year and set aside 50% for transfer to the Foundation);
- Foundation grant income (about $1.0 million per year revenue) from transferred trusts and endowment funds – gifts to the church over many years;
- sales of books and resources through the United Church Resource Distribution system (about $800,000 per year but declining);
- other revenues (about $2.0 million per year) on items such as fees for services provided to related organizations, commissions on the Pre Authorized Remittance (PAR) program;
- recovery of costs charged to other bodies including the Group Insurance and Pension plans. We refer to such activity as "self-funded". This totals more than $2.5 million.

Grants consist of:

- grants to global partners. Note that the Executive has approved a new approach to overseas personnel where we now deploy 3 staff to animate and support shorter term mission trips by congregations ($3.2 million per year – now a combination of direct grants and the 3 staff mentioned);
- grants to congregations and community ministries in Canada through the Mission Support Grant process administered by the Conferences ($3.2 million per year);
- grants to theological colleges and education centres ($1.4 million per year);
- grants to Conferences to support their staffing and operating costs (about $2.6 million for 2016 and 2017 – scheduled to be phased out by 2019);
- our new Embracing the Spirit program focused on new initiatives. This program has an ambitious target allocation of 10% of M&S;
- other grants to support the Observer, internships, candidacy and continuing education, (about $900,000 per year);
- Aboriginal ministry and right relations work is funded in each of the grant categories (except global).

Staff are the costs of salaries and benefits for those staff of the General Council Office funded through the operating budget. In the past, we have distinguished between positions funded from the Mission and Service Fund versus reserves. However, with the depletion of our reserves, this distinction is no longer meaningful. A very meaningful distinction remains though for positions and work funded externally which amounts to almost $3 million in 2017. This helps improve our economies of scale. We do not save money if we cut such positions.

Program costs are non-staff costs associated with operating various programs or services. Such costs include production of resources, holding conferences, events and consultations, purchasing of supplies and professional fees.

Meetings and Travel are the costs of transporting and accommodating people for meetings of the approximately 35 task groups and committees, including the General Council and Executive meetings, as well as travel for staff. The number of groups has been cut in half in recent years.

Operating costs consist of office rent, audit fees, banking charges, insurance, archives, telephones, computers, office operations

Guiding Principles

The principles underlying the 2017– 2019 Financial Plan are those of sustainability, long-term viability, a focus on mission over bureaucracy and endeavouring to not pre-judge or influence the remit process. We will aspire to some degree of stability and the capacity for emergent or unexpected work, but frankly that may be wishful thinking in the short term. Much attention will be required to the office space reduction and responding to remit outcomes.

- Wherever possible we are trying to preserve our investment in mission as opposed to administration, while recognizing that core administrative support is required to deliver any program.
- Financial sustainability means balancing expenditures with revenues as well as using reserves so that they support the work of the church and achieve the General Council Executive mandate to target a fully balanced budget by 2018 or 2019.
- Stability over the plan period means making more major adjustments as the results of the remits become known. Except for conference operating grants which will ultimately be eliminated, we <u>hope</u> to be able to maintain mission focused grant and staff levels for 2017 - 2020.
- Capacity for emergent or unexpected work means intentionally setting aside financial resources to respond to opportunities without necessarily having to reconfigure planned work in progress.
- The principle of spreading cost reduction across the whole church has also been used.

Assumptions, 2017 - 2018

1. Congregational and UCW givings were $23.7 million in 2016 and for budget purposes we project an annual decline of $900,000. We are hoping that the actual decline might be less than this, more in the range of $500,000 per year, and that other sources such as the Foundation continue to grow. We need to hope for the best, but plan for something less than that.
2. M&S bequests remain level over the next few years. M&S bequests are inherently variable but have averaged approximately $2 million per year.
3. With the transfer of trusts and endowments to the Foundation, the Foundation now grants income that was previously allocated through reserve transfers. The Foundation is also now financially self-sufficient. Income from the Foundation is expected to grow slowly from a base of $1 million.
4. Legacy and other fundraising efforts are underway to support congregations, community and other ministries, various church related institutions and the General Council. While these initiatives offer promise for some degree of revitalized funding, the fruits of these efforts are expect to slow rather than reverse the decline in Mission & Service. Should Remit 4 be approved, we hope that M&S would become more attractive to new donors.
5. Revenues from sales of resource materials and properties will decline slowly.
6. The Remits arising from General Council 42 may or may not be approved – in whole or in part.
7. The Cost of Living Adjustment for 2017 is 1.4%. The Executive has periodically discussed the possibility of not awarding COLA, but to date has decided not to exercise this option for cost savings.
8. Significant expense reduction is needed irrespective of outcome of the remits process as otherwise reserve balances will fall below the 30 % of the annual operating expenses and would contravene The "Fund Policy" (2006-04-28-367).

Initiatives with a Financial Impact

- <u>Office space reduction –</u> This initiative was approved by the Executive last fall, and entails reducing our office space by 60%. One time capital costs net of inducements received will be amortized over 6 years. Given the strategic importance of this initiative, we would be prepared to increase this budget to ensure a successful outcome.

- Use of Technology – The lower cost and higher quality of communications and information technology present new opportunities to save cost by reducing travel and reducing our impact on the environment.
- Simplification – Our emphasis continues to be to simplify the internal procedures and our reliance on paper, so that we can save time and staff resources.

Operating Principles

- Rolling three year plan, updated annually – Our normal practice is to look forward three years, continually updating the plan every year, so that we are planning ahead. This is normally a relatively arithmetic exercise, but is far more complicated right now by the uncertainty around whether remits are approved or not – in whole or in part.
- We look for partnerships to share costs and resources – Whether internally with the other courts of the church, ecumenically with other denominations or externally with other partners, we look to pool our resources for greater efficiency and effectiveness.
- We support new, innovative initiatives and ministries – While we continue to support our existing infrastructure and ministries; we recognize that we need to be vigilant for opportunities for innovation and expansion into new ministries.
- We need flexibility, to be able to react to changing conditions – Economic conditions, such as the stock market and interest rates; funding decisions by government bodies and the stability of the church's partners have all changed radically in the recent past. Our planning needs to be able to respond more quickly and creatively to this type of change.
- We aim to connect the work to be done to the volunteer resources available – There is a wealth of knowledge and experience in the whole church.

Assumptions

- Modest inflation for the next three years – A maximum annual inflation rate of 2.0% is expected over the next three years.
- Likely volatility in financial markets but with modest positive returns – With the church's conservative portfolio we hope to continue to make a modest income over the next three years although there is more risk of a market correction. Most of the income however accrues to restricted funds because we have drawn down our unrestricted funds
- Fully funded pension plan – The pension plan continues to be fully funded. With the large proportion of pension plan participants being retired, we assume that the church will not be called upon to fund any pension plan deficit over the next three years. Should that happen, the plan would need to be updated.

Constraints

- A stable work environment for staff – Working within the economic conditions stated above, we recognize that the staff need a stable work environment within which to work. We endeavour to be as transparent as we can about the overall financial picture and uncertainty therein. We strive to utilize attrition and work reduction where possible. We are committed to improving the amount and quality of training as we implement new technology solutions.

- A stable environment for our partners – Our partners, in the church, within Canada and abroad, rely on us for stable funding. To the greatest extent possible we will honour our relationships and give as much notice as practical if they need to change.

Sensitivity Analysis

In any forecast, some parts are more sensitive to changes in the assumptions than others. For example, the church will pay much lower rent after our office consolidation, but that new rent is now locked in until 2023 regardless of changes in the inflation rate, the general economy or the level of givings. Sensitivity analysis looks at the effect on the forecast of assumptions not being met or other changes which the church might experience.

Mission & Service Bequests

Bequests are difficult to forecast due to both their size and their frequency. The decision to leave money to The United Church of Canada may have been made over twenty years prior to the money being received. Bequests can be very large. Some have specific instructions and others have only general guidance. Traditionally, we have averaged about $2 million per year, although the amount has declined in recent years.

We are committed to moving away from using one time gifts to fund current operations. Currently 50% of annual bequests are set aside and transferred to the Foundation with only income available to support the operating budget.

Investment Income

In our budget presentation, we show investment income and any changes in unrealized gains or losses below the operating surplus/deficit. We budget for a 4.5% return.

Mission & Service Givings

The forecast for M&S is a year over year decline of $900,000. There are many factors which affect M&S givings, including the declining number of congregations and overall active membership in the church. There is provision in our modelling for changes in M&S as a result of the remit process.

On the plus side, communications technology allows the church members to get involved with the work of the church as it happens.

Expenses

Most of the expenses in the budget are fixed (e.g. rent) or controllable (e.g. salaries, grants). We continue striving to reduce travel and meeting costs by reducing the number of committees, their size and the number of face to face meetings. Staff travel is also being reduced by focusing on video conferencing and the use of technology.

Response

A financial plan is based on the best available information at the time of the plan. If revenues are lower or expenses higher than planned, the plan will be updated to respond.

Reserves

Purpose

The reserves serve several purposes:

- As a source of money in times of emergency, i.e. that an amount equal to 30% of one year's operating expenses be kept on hand (See Figure 4);
- As a place to store resources for future use or new initiatives, e.g. the Morrison Bequest was intended to be spent over a period of years;
- As a shock absorber to ensure that the church is safe from fluctuating economic conditions, e.g. the investment reserve where gains and losses are averaged; and
- As a place to store money designated for a specific purpose.

Operations Budget Exhibit

2016 Results vs Budget and 2017 Proposed Budget ($000's)

	2015 Actual (per audit)	2016 Budget	2016 Actuals for the 12 mos ended 12/31/16 (unaudited)	2016 YTD Actual Over (Under) 2016 Budget ($)	2017 Budget	2017 Budget Over (Under) 2016 YTD Actual ($)
Revenues:						
Contributions						
M&S Contributions	22,989	22,039	22,341	302	21,475	(866)
M&S Contributions - UCW	1,383	1,333	1,304	(29)	1,304	-
M&S One Time Gifts (net)	1,597	1,125	1,159	34	1,125	(34)
Total M&S	**25,969**	**24,497**	**24,804**	307	**23,904**	(900)
Non M&S Bequests (net)	241	255	286	31	213	(74)
Total Contributions	26,210	24,752	25,090	338	24,117	(973)
Other						
Foundation Grants	606	1,000	970	(30)	1,000	30
Retail Sales	1,106	1,091	787	(304)	864	77
Other Revenues & Recoveries	5,465	4,814	4,717	(97)	5,313	596
Total Other Revenue	7,177	6,905	6,474	(431)	7,177	703
Total Revenue	**33,387**	**31,657**	**31,564**	**(94)**	**31,294**	**(270)**
Expenses						
Grants						
Global Grants	3,271	2,736	2,676	(60)	2,736	60
Global Overseas Personnel	329	481	155	(326)	481	326
Cdn Mission Support	3,726	3,200	3,154	(46)	3,200	46
Conference Operating	3,736	2,804	2,546	(258)	2,578	32
Theological Schools & Ed Centres	1,621	1,400	1,539	139	1,555 **1**	16
Embracing the Spirit	-	250	235	(15)	750	515
Other Grants	809	1,057	1,240	183	863	(377)
Total Grants	**13,492**	**11,928**	**11,545**	**(383)**	**12,163**	**618**
Externally Funded Costs	**2,813**	**2,770**	**2,528**	**(242)**	**2,713**	**185**
Other Expenses						
Staff Costs	10,718	11,441	10,635	(806)	11,477	842
Resources	1,907	1,655	1,389	(266)	1,444	55
Travel Expenses	631	518	541	23	613	73
Committee Meeting Expenses	1,939	926	877	(49)	1,153	276
Office Costs	2,712	2,862	2,377	(485)	2,460	83
Professional Fees	1,371	1,409	1,493	84	1,645	152
Property & Insurance Expenses	211	225	207	(18)	206	(1)
Banking fees	205	260	208	(52)	210	2
Total Other Expenses	**19,694**	**19,296**	**17,726**	**(1,570)**	19,208	**1,482**
Total Expenses	**35,999**	**33,994**	**31,799**	**(2,195)**	**34,084**	**2,285**
Operating Surplus or (Deficit)	**(2,612)**	**(2,337)**	**(236)**	**2,101**	**(2,791)**	**(2,555)**
Investment Income/Gains	**844**	**929**	**1,199**	270	**753**	(446)
Final Operating Surplus (Deficit)	**(1,768)**	**(1,408)**	**964**	**2,371**	**(2,038)**	**(3,001)**
Available Unrestricted Reserves	**18,528**	**18,956**	**25,514** **3**	**6,558**	**22,031**	**(3,482)**
% of operating	**51.5%**	**55.8%**	**80.2%**		**64.6%**	

1- Includes student aid of $155, previously included in "Other Grants"

2- Excludes move costs to be capitalized and amortized over 6 years

3- Unrestricted reserve balance - estimate