

LUTHERAN CHURCH EXTENSION FUND (LCEF)

VANDA TONER
DISTRICT VICE PRESIDENT
NORTHERN ILLINOIS DISTRICT

The mission of Lutheran Church Extension Fund is to support the Church in fulfilling its mission of sharing the Gospel of Jesus Christ by being a Christ-centered servant partner of the LCMS, ensuring that funds and services are available now and in the future.

Organization Overview

Lutheran Church Extension Fund (LCEF) is an organization that empowers ministry. Incorporated in 1978, LCEF continues a long history of extension fund service to The Lutheran Church—Missouri Synod (LCMS) and its individual and corporate members. Through the dollars invested by thousands of individuals, congregations, schools, organizations and businesses, LCEF assists ministries with custom loans and ministry support services. Together, these partnerships have grown total assets to \$1.8 billion.

There are many ways to become a part of the LCEF ministry, collectively doing the work God has planned for us. Historically, church extension operations have centered on loans made possible through investments and gifts from dedicated church members and supporters. Today, LCEF has expanded its offerings to include resources that help put ministry in motion. VisionPath, Capital Funding Services (CFS) and Laborers For Christ (LFC) are examples of services offered to enhance and support ministries.

Bart Day serves as president/CEO and reports to a 12-member Board of Directors. LCEF employs some 110 people located in St. Louis and more than 50 employees in 30 member districts throughout the United States. The organization also counts on the service of hundreds of volunteers, such as Laborers For Christ and LCEF Advocates, to fulfill its mission.

In the national office, the investment processing area cares for nearly 60,000 LCEF investors, including individuals, LCMS ministries and entities, Recognized Service Organizations (RSOs), businesses and partner churches. LCEF's loan department serves LCMS ministries and Rostered Church Workers (RCW), providing customized loans including mortgages, construction loans and lines of credit. LCMS ministries connect to LCEF through their District Vice President (DVP), who works through the district office—they are a part of the Lutheran communities in which they serve. District Vice Presidents are supported by their district support staff as well as the national office staff in St. Louis.

Economic Overview

During fiscal 2017, the economy continued its moderate growth trend with unemployment improving throughout the year due to strong jobs reports. After the surprise presidential election of Donald Trump in November 2016, interest rates climbed quickly and equities reached new records in reaction to anticipated policy changes such as tax reform, stimulus packages, decreased regulations and the repeal of Obamacare. As of the end of June, the S&P index has risen nearly 14% since the November election in spite of the fact that Congress has not acted on the Trump agenda. Expectations for continued earnings growth—buoyed by strong employment, growing consumer and business confidence, housing demand and broad-based global growth—support the current valuations and prospects for additional growth into late 2017.

Improving economics has moved the U.S. out of the era of Quantitative Easing (QE). Rates have been increasing. At its December 2015 meeting, the Federal Open Market Committee (FOMC) increased short-term rates by .25%, the first change since December 2008. Since then, the Federal Reserve has voted to increase rates by an additional .25% during each of the December 2016, March 2017 and June 2017 meetings. The prospects for another .25% increase during the December or January FED meeting are 78%.

From a market perspective, the three-year treasury rate (which correlates with the average term of LCEF's intermediate fixed-income portfolio) rose dramatically during the fiscal year from the post Brexit vote low in July 2016 of .71% to a high of 1.69% closing at 1.6% at the end of the fiscal year in June, 2017. The Federal Reserve continues to assure the markets that the return to a more normalized rate environment will be data driven, and it is expected that, unless inflation begins to increase at a faster pace, these adjustments will be gradual.

LCEF's investment portfolio is heavily weighted to fixed-income investments, and the rising rate environment, while providing increased yields over time, resulted in unrealized losses in its intermediate bond portfolio. To hedge against these losses, LCEF maintained a short duration approximating two years, and a longer-term portfolio of other investments that historically over time have proven to be non-correlated to rising interest rates. The good news during fiscal year 2017 is that the long-term portfolio generated market gains of \$6.0 million which offset in part the market value losses of \$10.55 million on the fixed income portfolio.

LCEF's Performance – Fiscal 2017 Highlights

Against the backdrop of the economic overview provided above, during fiscal year 2017 (FY17), LCEF was blessed to serve the ministries of the LCMS and achieved or exceeded many of the financial targets and goals outlined in the prior year Ministry and Business Plan. LCEF ended the year with total assets reaching \$1.8 billion and achieved net income of \$8.8 million. Once again, LCEF was able to distribute operating results to the LCEF Districts and to the Synod and also made an allocation approximating \$1.2 million to the Kaleidoscope Fund – a granting initiative sponsored by LCEF.

Details of the financial performance for FY 2017 are listed below:

- The Ohio District CEF consolidated its operations with LCEF effective April 01, 2017.
- The South Dakota CEF decided to consolidate its operations with LCEF effective October 15, 2017, the third CEF district entry in the past two years.
- Total Assets increased \$31.1 million or 1.7% to \$1.839 billion since June 30, 2016, due to the entry of the Ohio District CEF.
- Management continued to maintain high levels of liquidity with cash and investments totaling \$317.2 million or 19.6% of notes and support dollars payables at June 30, 2017.
- Maintained a strong capital ratio of 11.7%, an increase of .4% when compared to the prior year.
- Cost of Funds (COF - the base from which loan rates are set) remained stable at 1.875% during the year, translating to very low-cost loans to organizations and Rostered Church Workers in FY 17.
- LCEF continued the multi-year increase in investors, achieving a net increase of 1,264 new investor relationships. This increase resulted from the entry of the Ohio CEF transferring 765 investors, the continued success of ConnectPlus and PartnerPlus term notes and the Young Investors (Y.I.) offering during the year.
- Loans receivable increased by \$70 million to a balance of \$1.5 billion.
- LCEF's loan disbursements were \$95.7 million higher than the prior year, totaling \$270.1 million which exceeded loan principal repayments by \$50 million, resulting in a reduction in short-term investments.
- During FY 2017, the delinquency rate increased to .7% from .4% the prior year, still a historically low level of delinquencies.

- Impaired loans decreased from \$129.8 million at June 30, 2016, to \$104.8 million at the end of FY 2017. Impaired loans include nonaccrual loans and loans for which LCEF has modified repayment terms from the terms included in the original loans agreements.
- Nonaccrual loans decreased to \$72.1 million compared with \$87.3 million at June 30, 2017. Associated interest reserves totaled \$900 thousand.
- The total allowance, as of June 30, 2017, totaled \$29.4 million or 1.96% of the loan portfolio, compared to \$37.3 million or 2.6% at June 30, 2016. The decrease in reserves represent write-offs associated with the resolution of certain specific impaired loans.

LCEF continues to be blessed by the strong support of its investors and the dedicated commitment of its borrowers. Because of this partnership, LCEF is well positioned to serve the ministries of The Lutheran Church — Missouri Synod today and in the future.

Core Initiatives for Fiscal Year 2018

As outlined in LCEF's Ministry and Business Plan for the fiscal years ending June 30, 2018 – 2020, LCEF is focused on the following core initiatives:

- Prepare for and adapt to internal and external change as we embrace the evolving needs of our customers and adjust to new leadership within the organization.
- Develop a greater partnership with LCMS entities and Synod, Inc., building upon synergies and strengths of the organizations in support of ministries we commonly serve.
- Ensure continued financial and operational health of the enterprise, having resources available in support of ministries and partner churches of the LCMS today and in the future.

Based on its financial forecast for the fiscal year ending June 30, 2018, and in line with the core initiatives outlined above, LCEF expects:

- Total assets to decrease \$14.1 million, or .01% to \$1.825 billion.
- Liquidity to remain strong, maintaining a ratio approximating 19% of notes & support dollars payables.
- Net assets to increase to \$223.1 million representing a capital-to-asset ratio of 12.2%.
- Loans receivable to increase to \$1.522 billion.
- Notes and support dollars payables to decrease to \$1.593 billion.
- Net income to total \$8.9 million.
- Loan delinquencies to remain at a level below 1.75% and non-income producing assets, non-accrual loans and real estate to decrease by \$12.1 million.

Other objectives include:

- Following three years of planning and preparation, two of three regional operations centers have opened their doors in Minneapolis/St. Paul, which is serving as the operational hub for Central Region and Mission Viejo, California, which is now serving as the operational hub for the West Region.
- One additional regional center is scheduled to open during the coming fiscal year with an office planned for Orlando, Florida. The East Region office will complete the first major phase of the larger de-centralization efforts designed to increase and improve LCEF's ability to first discern and then respond to the continually evolving needs of our customers across the country.
- National loan staff will actively engage and interact with district and regional support networks. They will seek increased opportunities with the non-congregational borrowing base, and in conjunction with the Lutheran Federal Credit Union, will expand the Rostered Church Worker (RCW) Loan Program to states beyond the current 16 where LCEF is licensed.
- Marketing will engage with and support the regional and district offices to better understand their unique needs so it can properly support their ministry efforts.

- Marketing will update the website to reflect a blog-centric content strategy and user-friendly 13 Annual Meeting 2017 experience. Marketing will implement a strategy to retire and/or redefine the investor products ensuring LCEF's product line remains strong and relevant offering investors a complementary mix of demand and term products.
- Laborers For Christ (LFC) will complete a comprehensive study and re-design of its business model to reflect current sociological and economic realities with a focus on long-term sustainability.
- Capital Funding Services will develop a capital campaign strategy utilizing a team approach of individual 'experts' within various components of a campaign for conducting campaigns in larger churches.
- District and National Operations (DNO) will continue dialogue with other synodical agencies to develop operational models for the future that seek to leverage the LCEF regional structure.
- Loans will seek opportunities to network with other synodical agencies in conjunction with product development, customer support and loan promotion efforts, and will actively participate in district and nationally hosted events, taking advantage of opportunities for key sponsorships.
- Loans will explore strategic partnerships with LCMS entities and partner churches and expand relationships with Recognized Service Organizations and associations of LCMS elementary and high schools.
- Information Technology will connect where appropriate with LCMS entities to increase communications in the areas of cybersecurity, customer relationship management and vendor management.
- Facilities Management will leverage existing relationships with partners such as Foundry Commercial, LCEF's real estate partner, to assist entities and customers with maintenance and management of physical infrastructure, analyzing building operations and suggesting improvements and opportunities for savings.
- Benefiting from networking opportunities with the Concordia University System through the National Student Marketing Competition, Marketing will host a high school entrepreneur competition in the St. Louis area with a desire to have a nationwide program in the future. They will also organize networking events and mutual learning sessions with various LCMS entities.
- Ministry Support will consider partnering with the Office of National Mission (ONM) to develop a ministry geared to older LCMS members. In concert with the synodical stewardship group, Ministry Support will determine new stewardship opportunities for LCMS congregations.
- DNO will continue to place a strong emphasis on growing the roles of investing partners with the LCEF. Cultivation, development and ongoing maintenance of these investor relationships will drive lending activities for the foreseeable future.
- Loans will continue to work with impaired borrowers to return a significant portion of these loans to the active loan portfolio.
- Finance projects LCEF will achieve sufficient net income that will provide for distribution of operating results and contributions to the Kaleidoscope Fund. Finance will also expand awareness and focus of LCEF's Enterprise Risk Management (ERM) process, ensuring accountability and engagement throughout the organization.

LCEF has truly been blessed with positive financial results, loyal support from its investors and faithful commitment from its borrowers. Through this support, LCEF has been able to meet the loan needs of ministries within the LCMS and maintain its strong financial position. LCEF once again distributed portions of its operating results to participating districts and the Synod along with ministry grants through the Kaleidoscope Fund. Management remains committed to supporting those ministries struggling financially, in a firm yet encouraging way, confident that God will provide a path for faithful ministries to continue to fulfill the mission of sharing the Gospel.