

Permanent Fund Financial Report Rotary Year 2003 - 2004

The mission of The Rotary Foundation is to support the efforts of Rotary International in the fulfillment of the Object of Rotary, Rotary's mission, and the achievement of world understanding and peace through local, national, and international humanitarian, educational, and cultural programs.

The life-blood of The Rotary Foundation has always been the enthusiastic support of Rotarians, voluntarily giving generously of their time and financial resources. It is this support, which has made possible the various educational and humanitarian programs of The Rotary Foundation. These programs give Rotarians a sense of great satisfaction and fulfillment, and reinforce the powerful network that links Rotarians in local, national, and international service. The Rotary Foundation focuses its strength and resources to bring harmony and friendship to mankind and to bring understanding among nations to achieve peace.

1) What is the purpose of the Permanent Fund?

The Permanent Fund was established in 1982 to ensure a strong future for the Foundation by providing an extra stream of income to meet the increasing demand for the Foundation's programs and to expand its ability to meet urgent human needs around the world. Donors invest in this endowed fund which builds long-term stability for the Foundation's future.

Rotary International's Board of Directors and the Trustees of The Rotary Foundation have identified the following programs as priorities for program spending:

PolioPlus

Rotary Ambassadorial Scholarships

The Rotary Centers for International Studies in Peace and Conflict Resolution

Group Study Exchange (GSE)

Matching Grants for International Humanitarian Projects

Individual Grants for International Humanitarian Programs

District Simplified Grants for International Humanitarian Programs

Health, Hunger and Humanity (3-H) Grants

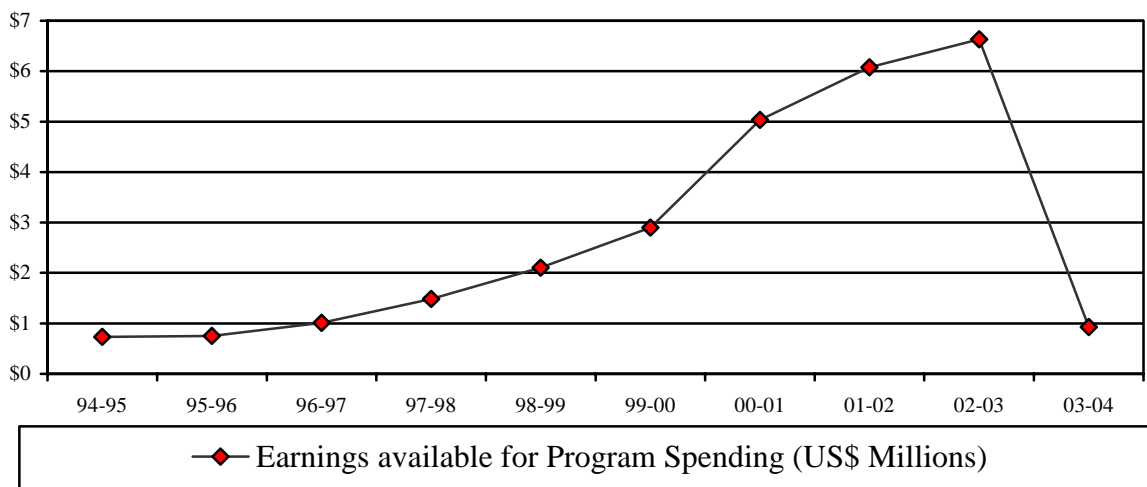
2) How much is spent on programs each year from the Permanent Fund?

Each year the Trustees review the spending policy to ensure that the real value of the Permanent Fund grows over time and that the annual spending rate does not exceed the expected long-term rate of return less the expected rate of inflation. In years when the inflation-adjusted investment return is greater than the spending rate, the "surplus" will be reinvested to cover those periods when the inflation-adjusted investment return is less than the spending rate. During fiscal year 2003-04, the policy called for spending 6.5 percent of the three-year average of the Fund's market value on programs. However, due to steep declines in the financial markets the prior three years, the market value of the Permanent Fund fell below the cumulative gift amount (the "corpus"). Therefore, the Trustees did not authorize any spending from the Permanent Fund in fiscal 2003-04 to avoid invading the corpus of the Fund. Because some scholarship awards from the Fund already had been committed, the Trustees authorized the World Fund to pay these awards if the market value of the Permanent Fund was still below the accumulated gift value at

the time the payments were to be made. Due to strong investment markets during fiscal 2003-04, the market value of the Permanent Fund grew substantially, and the Permanent Fund was able to pay the scholarship awards without invading the corpus.

Effective 1 July 2004, the Trustees reduced the spending rate to 4.5 percent, of which 3.75 percent will be allocated to program awards, 0.25 percent to program operation expenses, and 0.50 percent to fund development and general administrative costs.

The table below details the dollar amounts made available from the Permanent Fund in support of annual programs of the Foundation.



3) Management of Investments

The Trustees of The Rotary Foundation are responsible for the general direction and control of the Foundation's investments and have established a specific investment policy for each fund.

Experienced, professional external investment managers are appointed to invest Foundation assets in accordance with their judgment concerning relative investment values and in compliance with the Trustees' investment policies.

The Foundation's Trustees, staff, and investment consultant closely monitor the performance of the investment managers and their compliance with policy guidelines. Quarterly investment reports are sent to the Trustees and key investment issues or concerns are discussed in depth at their October and April meetings.

4) Investment Structure

The Permanent Fund is invested in four asset classes. Below is a chart that shows the managers and composition for each of the investment pools. The target asset allocation of the fund is 60% U.S. stocks, 20% Non-U.S. stocks, 15% bonds, and 5% real estate.

State Street Bank and Trust (custodian bank)
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(60%) U.S. Equity Pool ⁽¹⁾	
managed by	
Barclays Global Investors	(40%)
Institutional Capital	(20%)
Trust Company of the West	(20%)
MA Weatherbie & Company	(10%)
High Rock Capital ⁽²⁾	(10%)

(15%) Fixed Income Pool	
managed by	
Pacific Investment Mgmt Company	(50%)
Reams Asset Management	(50%)

(20%) Non-U.S. Equity Pool	
managed by	
Capital Guardian Trust Company	(100%)

(5%) Real Estate	
managed by	
UBS Brinson	(100%)

⁽¹⁾ The Permanent Fund has committed \$3.25 million to private equity investments through INVESCO Private Capital and Collier International Partners. As of 30 June 2004, \$1,005,683 had been invested.

⁽²⁾ This manager was terminated in July 2004 and replaced by J.L. Kaplan Associates.

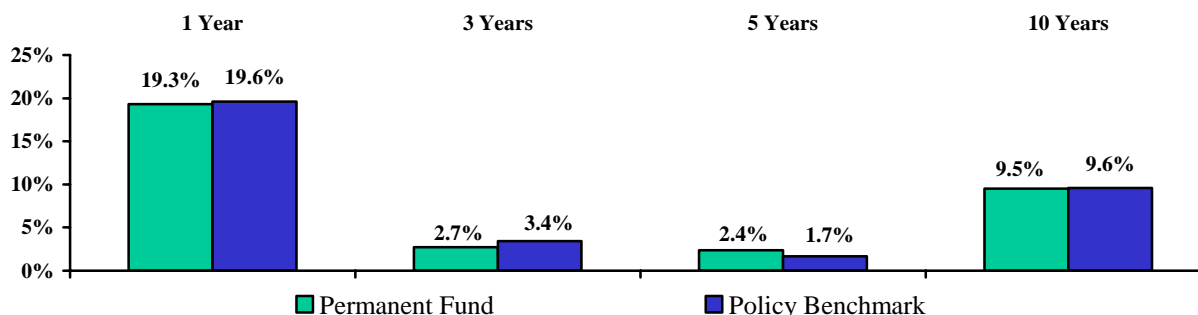
5) What is the investment objective for the Permanent Fund and how is the performance monitored?

The Rotary Foundation invests Permanent Fund assets in such a manner to ensure that the organization provides adequate funding for today's programs while sufficiently growing the portfolio to support the Foundation's programs in the future. The primary goal is to preserve and grow the corpus at a rate greater than inflation so that the real purchasing power of the fund is maintained.

Over a reasonable time period the funds are expected to achieve a rate of return in excess of the *Policy Benchmark* (see below) and the average return of similarly managed endowments.

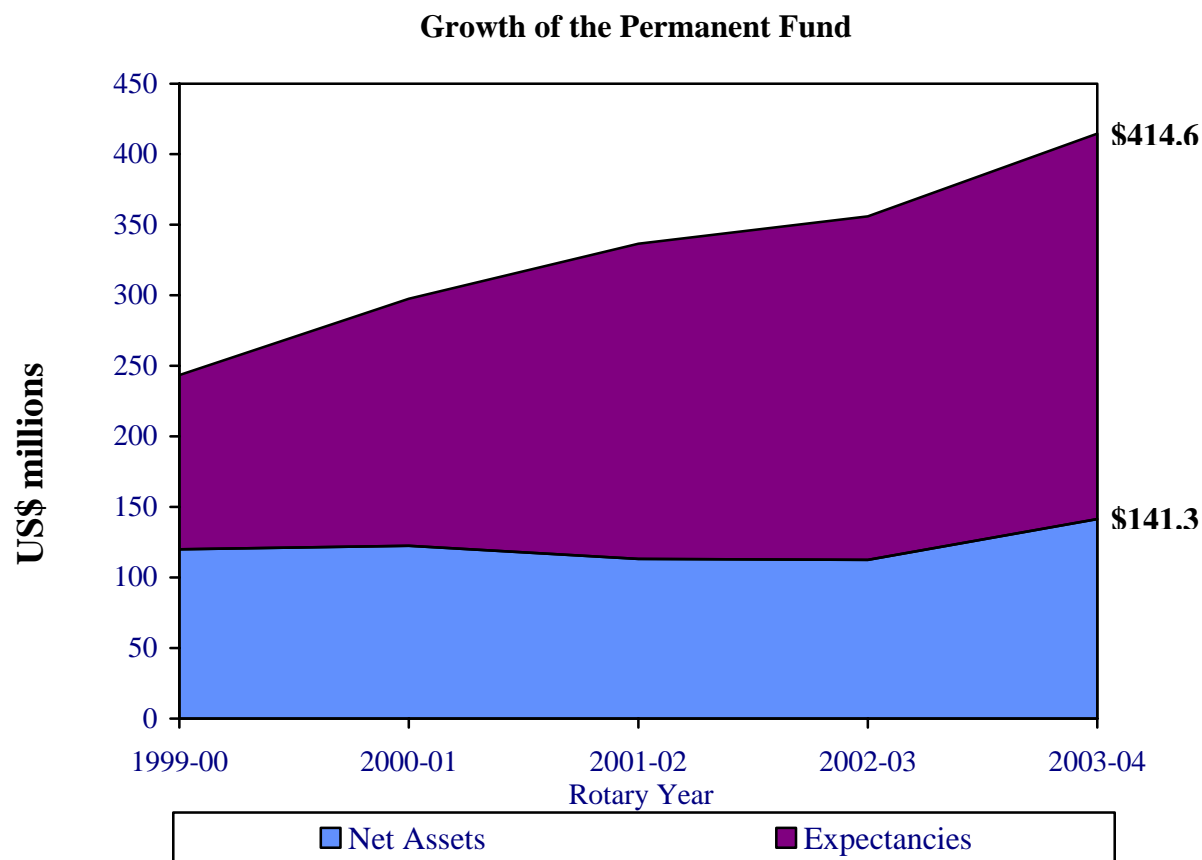
6) What has been the investment return for the Permanent Fund?

The investment returns for the Permanent Fund are total returns net of fees. The *Policy Benchmark* consists of indexes, such as the Wilshire 5000 for U.S. stocks, the Lehman Brothers Aggregate Bond index for fixed income securities and the Morgan Stanley All Country World ex-U.S. Index for the non-U.S. stocks. The benchmark is weighted to reflect the target asset allocation of the Permanent Fund during each fiscal year, and it represents the actual performance of the asset classes. The chart below shows the recent and long-term performance of the Fund for periods ended 30 June 2004. All periods greater than one year have been annualized.



7) What has been the growth of the Permanent Fund?

As of 30 June 2004, the net assets of the Permanent Fund, including life income agreements, were \$141.3 million. The Foundation also tracks expectancies to the Permanent Fund. Expectancies represent commitments made for future gifts, but they are not currently assets of The Rotary Foundation and are not included in the financial statements. These commitments typically appear as a provision in a person's will, or other estate plan, naming the Foundation's Permanent Fund as a beneficiary. The Permanent Fund's net assets plus expectancies equaled \$414.6 million as of 30 June 2004.



(US\$ millions)	99-00	00-01	01-02	02-03	03-04 ¹
Beginning Net Assets	105.2	119.9	122.5	113.1	112.6
Contributions and Pledges	9.0	12.2	8.9	5.3	9.3
Investment Income	9.0	(4.9)	(12.7)	0.4	20.3
Total Spending	(3.3)	(4.7)	(5.6)	(6.2)	(0.9)
Ending Net Assets	119.9	122.5	113.1	112.6	141.3
Expectancies	123.4	175.0	223.6	243.4	273.3
Total	243.3	297.5	336.7	356.0	414.6

¹ Numbers are preliminary and unaudited.

8) How can I contribute to the Permanent Fund?

The Permanent Fund provides Rotarians and other friends of the Foundation a way to create their own lasting legacy with Rotary. Contributions to the Permanent Fund tend to be larger than contributions to the Foundation's Annual Programs Fund and are often initiated through a bequest. For special endowing opportunities for gifts of US\$25,000 or more, please refer to the Foundation's Named Funds brochure or contact Foundation staff directly.

9) Contributing to the Permanent Fund through a Life Income Gift.

An increasingly popular way of giving to the Permanent Fund is through life income gifts. These gifts provide an income stream during the lifetime of the income beneficiary. After the death of the last income beneficiary, the remaining assets are placed in the Permanent Fund. Because of the unique nature of life income gifts, they are managed outside of the Permanent Fund and each has a separate investment structure. Life income gift assets are not included in the spending calculations for the Permanent Fund. However, they are included in the net assets of the Permanent Fund in the table above. The Foundation manages life income gifts worth US\$15.3 million (as of 30 June 2004).

Life income agreements may offer donors the following benefits: an annual income stream; an immediate US federal income tax deduction; avoidance or reduction of capital gains taxes on gifts of appreciated assets; and possible estate tax savings. The main types of life income gifts are:

- Charitable Remainder Trusts: A charitable remainder trust is an irrevocable transfer of assets to a trust in exchange for payments to the donor or other beneficiaries. Trust payments can be fixed or provide a variable payout. Rotary's trusts typically maintain a fairly high equity allocation to generate long-term growth greater than the rate of inflation.
- Charitable Gift Annuity: In exchange for an irrevocable gift of cash or securities to establish a charitable gift annuity, The Rotary Foundation agrees to pay one or two annuitants a fixed sum each year for life. The number of annuitants and their ages determine the annuity rate. The payments are backed by the unrestricted assets of The Rotary Foundation.
- Pooled Income Fund: An irrevocable donation of cash or securities to the pooled income fund is invested together with the gifts of all other pooled income fund donors. Quarterly income payments are made on a proportional share of the fund's income; the amount of the payments varies with the fund's earnings and performance. The fund is invested in a mix of stocks and bonds to balance the need for current income with long-term growth of principal.

10) How is my commitment or gift to the Permanent Fund recognized?

Anyone who informs the Foundation in writing that he or she has made a provision in their will or estate plan naming The Rotary Foundation's Permanent Fund as a beneficiary, or anyone who makes an outright gift of US\$1,000 or more to the Permanent Fund is recognized as a Benefactor. Bequest Society recognition is extended for bequest commitments worth at least US\$10,000. Major donor recognition is presented for outright contributions and life income gifts of US\$10,000 or more. In appreciation for outright gifts of US\$25,000 or more, the Foundation will honor the donor's contribution by establishing a special Named Fund within the Permanent Fund.

11) How Do I Obtain Additional Information?

Visit Rotary's website at www.rotary.org. If you are interested in learning more about life income agreements or endowment opportunities within the Permanent Fund, please contact Eric Schmelling, Director of Planned and Major Gifts, your zone's Major Gift Officer, or your local Rotary International office.

Director of Planned and Major Gifts	Eric Schmelling	(847) 866-4458
Director of International Fundraising	Lawrence E. Shawver	(847) 866-3351
Planned Giving Officer	Karena Bierman	(847) 866-3100
Senior Major Gifts Officer, Zones 23 & 24	David E. Bender	(847) 866-3456
Major Gifts Officer, Zones 22, 25 & 26	Sean Allen	(847) 866-3190
Major Gifts Officer, Zones 27, 28, 29 & 30	Michael Smith	(847) 866-3220
Major Gifts Officer, Zones 31,32,33,34	Jackie McGuire	(847) 866-4450