Understanding Financial Ratios To Successfully Acquire Church Capital

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Introduction

When you are purchasing, constructing or refinancing a new sanctuary, fellowship hall, school, child care facility, community center, major renovations or repairs, preparation for obtaining the needed capital is the key to success. And understanding how your church is measured by banks or other lending institutions will give you the best opportunity for approval.

For Discussion

- Qualitative Factors Considered by Lending Institutions
- Quantitative Factors Considered by Lending Institutions
- How Much Can You Afford
- Church Underwriting Ratios
- Do's and Don'ts of Church Financing

For Discussion

- Documentation Required
- Keeping Good Records
- Loan Covenants
- Basic Closing Costs
- Relationship Factors

Is Now the ***Right*** Time?

- Has your church reached seating capacity?
- Has your church saved enough funds for down payment?
- Does your church need a new life center facility to attract younger members or a need to attract more members in general?
- Does your church need an alternative source of income?

Is Now the ***Right*** Time?

- Is the physical structure of your building experiencing delayed maintenance and in need of significant repair?
- Is the interest rate on your current church mortgage at least 5.75% or higher and you need to refinance?
- Do you have two or more mortgage payments and need to consolidate those loans for a lower payment?

Character and Qualitative Considerations

- Minimum of 3 years in existence
- Keep good records / Good quality financial statements
- Good payment history on existing loans or lease/rent contracts
- Senior Pastor should have a minimum of 18 months history with Borrower in this position
- The Board of Directors of the Borrower should be comprised of a majority of individuals un-related to the Senior Pastor

Character and Qualitative Considerations

- Borrower should have demonstrated a history of sound operations
- There should be evidence of strength, commitment and structure in the borrower's leadership.

Qualitative Factor

- **Date Founded**

  Particularly in the South and the East, many churches have been around for more than a century. While not an indication in itself of repayment capacity, the age of the church does provide an indication of the congregation's stability. A 50- to 100-year-old church has survived many economic cycles. This is often due to the commitment of its members during tough times. Start-up churches, then, require credit enhancements, such as guarantees from members or from other churches.

Qualitative Factor

- **History of Building Programs**

Because church loan requests are often for building additional facilities, it is helpful to know about any past building programs. Many older churches have successfully been through one or more building programs and have retired debts related to them. Keep in mind that while this history should be weighted, it is important not to place too much emphasis on it. Loans are never repaid from past cash flow.

Qualitative Factor

- **Families**

Family ties to churches often run deep, and it is not unusual, especially in older churches, to find second- and third-generation members. This provides further indication of the member commitment to the church. If members' commitment is strong, often their personal financial commitment is strong.

Qualitative Factor

- **Membership Trends**

  Like operating companies, churches go through stages of start-up, growth, maturity, and decline. Membership trends are a key indicator of where the church is in its life cycle. Borrowing needs will vary with each stage. A lender will be wary of extending a loan for expansion of facilities to a church with declining membership. It is important to delineate between a sustained trend and a temporary glitch. Often a young church will lose a pastor and growth will stagnate, but the trend will reverse once a new pastor with growth plans is in place.

Qualitative Factor

- **Church Leadership**
  - **Pastor/Staff**
    Determining the role of the pastor and the church staff is important, because church members (givers) are often loyal to particular pastors and/or staff members.

What Some Banks Might Ask. . .

- How many full-time associates are there?
- How long has the pastor been at the church?
- What is the pastor’s background?
- Has the pastor led a congregation through a building program before?
- Does this denomination rotate pastors?

Qualitative Factor

- **Church Leadership**
  - **Member Leadership**
    Congregations often rely on committees to provide advice on financing, building, and long-term plans. Problems can arise if the individual committee members do not have experience in these areas.

Qualitative Factor

- **Hierarchical Structure and Governance**

It is important to know how much control the governing body of the denomination has over property and staff.

For instance, in the Roman Catholic Church, the diocese owns the land and buildings of the local parishes. While the parish may be your primary source of repayment, the diocese is the obligor and owns the assets taken as collateral.

Qualitative Considerations

Church Underwriting Ratios

- Capacity
- Capital
- Collateral

How much can you afford borrow?

Assets		
Cash	$	200,000
Other Assets	$	700,000
Land, building and equipment	$	5,500,000
Total Assets	**$**	**6,400,000**
Liabilities		
Current Liabilities	$	200,000
Long Term Debt	$	2,000,000
Total Liabilities	$	2,200,000
Net Assets	$	4,200,000
Total Liabilities and Net assets	**$**	**6,400,000**

Income		
Tithes and Offerings	$	1,500,000
Other Revenue	$	100,000
Total Revenue	**$**	**1,600,000**
Expenses		
Salary	$	500,000
Interest	$	200,000
Utilities and other occupancy cost	$	300,000
Other Expenses	$	400,000
Depreciation	$	150,000
Total Expenses	**$**	**1,550,000**
Change in Net Assets	**$**	**50,000**

Debt Service Coverage – MAX 1.30 Times

DSC RATIO:

NET CHANGE IN ASSETS + DEPRECIATION + INTEREST EXPENSE / ANNUAL DEBT SERVICE

Expenses		
Salary	$	500,000
Interest	$	200,000
Utilities and other occupancy cost	$	300,000
Other Expenses	$	400,000
Depreciation	$	150,000
Total Expenses	**$**	**1,550,000**
Change in Net Assets	**$**	**50,000**

$50,000 + $150,000 + $200,000 = $400,000 / ANNUAL DEBT SERVICE
$400,000 / X = 1.30

X = $307,693 (Maximum Debt Service) X= $25,641 per Month

Solve for Loan Amount

Solve for Net Present Value

Interest rate on loan:	5%
Term of loan:	20 Years
Monthly payment:	$25,641
Annual payments:	$307,693
Loan Amount (Net Present Value):	$3,885,261
Payoff Existing Debt:	$2,000,000
Maximum New Money:	$1,885,261

Church Underwriting Ratios

- **Minimum Giving Units**

  A minimum of 250 is considered a good benchmark. Because giving units indicate stability, careful consideration should be given when considering requests to churches that have fewer than 250 giving units. In this situation, it is often necessary to obtain credit enhancements, such as personal guarantees.

Church Underwriting Ratios

- **Loan Amount / Gross Annual Receipt**

  This is often the first ratio calculated because it provides a good indication of the leverage the church is anticipating in relation to the annual income it is bringing in. The standard benchmark is 3. A greater number indicates the church is leveraging its present or projected intake rather highly. It is important here to include existing debt in addition to the anticipated loan. The anticipated income from any capital or fund-raising programs should also be included. For churches in growing areas that are expecting to add membership, this ratio will often be high, but then will come down as the church grows.

Church Underwriting Ratios

UNDERWRITING RATIOS			
APPRAISED VALUE	$ 4,700,000		
LOAN AMOUNT	$ 3,885,261		
DEBT SERVICE (ANNUAL LOAN PMT)	$ 307,693.00		
		GUIDELINE	**RESULT**
GIVING UNITS	750	250	Satisfactory
TOTAL DEBT / REVENUE	1.38	3.0X	Satisfactory
REVENUE / GIVING UNITS	$2,133	$1,250	Unsatisfactory
ANNUAL DEBT SERVICE / REVENUE	19%	33%	Satisfactory
LOAN / APPRAISED VALUE	83%	75%	Unsatisfactory
DEBT SERVICE COVERAGE	1.30X	1.30X	Satisfactory

Due to the unacceptable 83% LTV, the loan will therefore have to be reduced to 75% of the appraised value, which is $3,525,000.

Do’s and Don’ts of Church Financing

DO

- Deal with a lender who demonstrates an understanding of churches. Ask the lender how their church loan products, features, and covenants differ from their standard commercial loans.

- Have your financing firmly in place and in writing before starting your project.

- Before tendering escrow dollars under an agreement to buy land or buildings, be aware of entitlement, zoning and environmental issues.

- Ask the lender and the contractor for references

Do’s and Don’ts of Church Financing

DON’T

- Avoid mortgage brokers or lenders who ask your church to sign something prior to analyzing a loan application and offering a financing commitment.
- Meet with the lender to discuss the scope of the project before you spend large sums of money on architectural designs that may be too costly to build.
- Depend on the sale of your current facility or other uncertain future events to provide the funds to complete construction of your project

Required Documentation

Sources and Uses Statement	Capital Pledge Campaign
Religious Organization Application	List of key Church Leaders
3 Years of Financial Statements	Background Summary of Church and Pastor
Annual Budget	Plans and Specifications
Bylaws	Cost Estimates

Keep Good Records

Audited financial statements
Reviewed financial statements
Compiled financial statements
Internally prepared financial statements

The Loan Covenants

- Maximum Debt Service Coverage Ratio
- Minimum Liquidity Ratio
- Additional Debt in Excess of $50,000 Requires Bank Permission
- Borrower must maintain primary operating account at the Bank with a minimum average collected balance of 5% of the outstanding loan amount
- Borrower must maintain a minimum payment reserve at the bank equal to 6 months of payments
- Borrower must furnish Reviewed Financial Statements within 30 days of fiscal year end

Basic Loan Closing Costs

- $35,000 Loan Fee (Up to 1%)
- Appraisal ($2,500 to $7,000)
- Survey ($1,200 and higher)
- Environmental Phase 1 (Up to $3,000)
- Attorney Closing ($2,500 to $6,000)
- Title Insurance (Up to $10,500)

Relationship Consideration

- Electronic Tithing
- Cash Management Services
- Savings Accounts
- Commercial and Consumer Checking accounts
- Commercial Loans
- Commercial and Consumer Credit Cards
- Residential Mortgages

Thank You

CITIZENS TRUST BANK

A relationship you can bank on

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