

Pitfall #1 Falls to Avoid when Financing your Church Project

Having been actively involved in church financing for over twenty years, I've discovered a number of things that churches need to avoid or know before actually applying for a loan. Over the next several informational articles I'm going to discuss some of the pitfalls to avoid so that you will obtain the best terms and conditions.

Pitfall #1: Have your church financials prepared by a CPA to GAAP Standards. Lenders are accustomed to reviewing financials in a standardized format. There are three levels of financial preparation your CPA can provide. They are compiled, reviewed, or audited. Depending on how much the church wants to borrow will impact the level of review the lender will require. Financials prepared on QuickBooks by a nonprofessional are not satisfactory. You are borrowing money. You know what they say, "you only get one chance to make a good first impression. These services can range from a few hundred dollars to several thousand depending on the complexity of your organization. This is money well spent.

Pitfall #2 Counting the Cost

After all these years it still surprises me how often borrowers have not thought through the question of "how much can we afford to borrow". This is a question that really needs to be discussed among leadership and have acceptance from the congregation. The answer to this question will impact the ministries of the church, the ability to engage staff and sleeping well at night.

I read several years ago in Church Finance Today, that 68% of all growing churches have some debt. We could debate whether or not a church should have debt, but the reality is that most elect to have debt, at least for a period of time. The level of debt is very critical. There are a number of ways to evaluate the amount debt you can afford. There are generally accepted financial ratios you should be familiar with because lenders are going to use them, and they are the "doorkeepers" to your project's funding.

The first is the Debt Service Ratio. This ratio measures the percentage of debt payment compared to the "undesignated income". Undesignated income is often far less than the total income of the church because it does not consider, rental income, special gifts, mission gifts, school income, or special projects. Lenders will often accept 30- 35% as the maximum percentage. The lower this percentage the more balanced the ministry has the opportunity to become. In my personal opinion the ideal level is between 20-25% of undesignated income for the long-term.

Then there is the Debt Coverage Ratio. This is my personal favorite ratio in determining a borrower's ability to make their payments. This is a little more complex for the novice to calculate. The goal is to have a ratio of at least 1:1. This means that you have \$1.00 to pay towards every \$1.00 of monthly payment. You can calculate this number by taking the Net Income from your Income and Expense Statement (this will have been prepared by a CPA if you followed my advice from my first post) then add back in depreciation, interest, amortization costs, rental expenses, and any one time expenses. The higher the number the greater ability you have to make your monthly payment comfortably. Few banks will lend to you if the ratio is below 1:25 to 1.

There are many other factors that come into play when determining a borrower's ability to secure financing. Items like Loan to Value, Debt to Income, Liquidity (reserves), the Management Team, longevity of the pastor, trends in attendance, how long the church has been in existence, if the church is affiliated with a denomination, if there is hierarchical support and oversight. These are all factors and we'll discuss them over time.

The bottom line to Pitfall #2 is don't borrow more than you are sure you can repay. If you borrow so much that all you can do is make the mortgage payment, and not ministry, then you need to rethink your position. Jesus was clear in his admonition, "Be sure to count the cost before you start to build". That's the best counsel we'll receive.

Pitfall #3 Loan to Value

Whether it is your personal property or your church we all seem to believe that what we own is more valuable than it really is. We all recognize that home prices have fallen substantially in most areas of the country, but we don't apply that fact to the value of our church. It doesn't matter what the appraisal was a few years ago. Today values are lower.

The truth is that if you refinanced, relocated, or built new facilities after the peak in loan values around 2006-2007 it's very likely your loan to value has been reduced by 20-30% and maybe more. This is a challenge that many organizations are facing. Their institutional loan is maturing, and you are being told the lender wants you to refinance, (even if you have been faithfully making all the payments) because the loan to value is below their desired target. I know this seems very unfair, but it is a reality.

If you are preparing to build and are anticipating using the equity in your facilities be prepared for a loan to value surprise. You may need much more cash to apply to the project than anticipated.

What are the solutions? Know the value of your property. Know in advance what lenders are requiring in this environment. Knowledge allows you to plan well and position yourselves accordingly.

There are church finance solutions when loan values have declined, and we will discuss them in future blogs. Be assured that there are solutions.

Pitfall #4 Declining Trends of Income and Attendance

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Pitfall #5 Construction Projects

Another common mistake is that the church starts working on the building site before the title policy is in place. This is a major and costly error. Many lenders will not fund if any work has started. It's a serious liability issue for the title company.

Even though you have a contractor, it's a good idea to have an independent firm oversee the project to compare the draw requests to the work completed, that lien releases have been signed off, and the spreadsheets tracking the dollars spent against every line item are updated. No money should be released on-line items that are over spent. Cost control is critical on every project.

Change Orders. This has hurt more projects than can be counted. Even small changes can affect a number of other items, and what seems to be a simple change can be very costly. It's better to plan well and avoid this hazard.

Using a contractor is a good idea. They are professionals. Choosing the right one with the right experience and financial strength is critical. Projects without one often are very difficult to fund. Be sure to check references.