

We are Expanding...Can we get a Loan?

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Today's Topic...

Financial planning for a Loan

- I Great Blessings Church - Where should you start the journey?
- II Industry Update: Are Banks Lending and at what rates?
- III Important Metrics to Consider / Key Performance Indicators
- IV Strategies for Success in Obtaining the best loan terms

Where should you start the Journey?

Background Hypothetical Case Study

Great Blessings Church has experienced growth in attendance and giving. Church leadership has determined that expanding the sanctuary and building a family life center is needed to accommodate growth. Below are some base line assumptions:

Annual Church Budget: \$1mm

Current Attendance: 500

Undesignated Cash on Hand: \$100,000

No Mortgage debt – only Capital Lease Obligations related to office equipment

Background Case Study

Preliminary Project Cost Estimate: \$5mm

Building Fund Cash on Hand: \$500,000 (in addition to \$100k Unrestricted)

Question: Can Great Blessings fund raise \$2.5mm???

Can Great Blessings borrow \$2,000,000???

If you are the XP, what are your next steps.....

Establish a Team of Counselors Early on

- Don't go it alone.....Where there is no counsel, the people fall; **But in the multitude of counselors there is safety.**” Proverbs 11:14
- Surrounding yourself with Trusted Advisors (Counselors) is the safest path to know and understand financial health and debt capacity!
More about this later.....
- Who should be on this team within your church?

Key Counselors Outside the Church

- Architect
 - Baseball Analogy – Innings 1-3
 - Is \$5mm the Total Cost (soft cost, site work, FF&E).
- General Contractor
 - Design Build versus Third Party General Contractor
 - Work Toward Comprehensive Fixed Price or Guaranteed Maximum Price Contract.
 - Cost per square feet can vary - \$150 to \$400 per square foot
- Generosity Consultant
 - Does this fit your DNA?

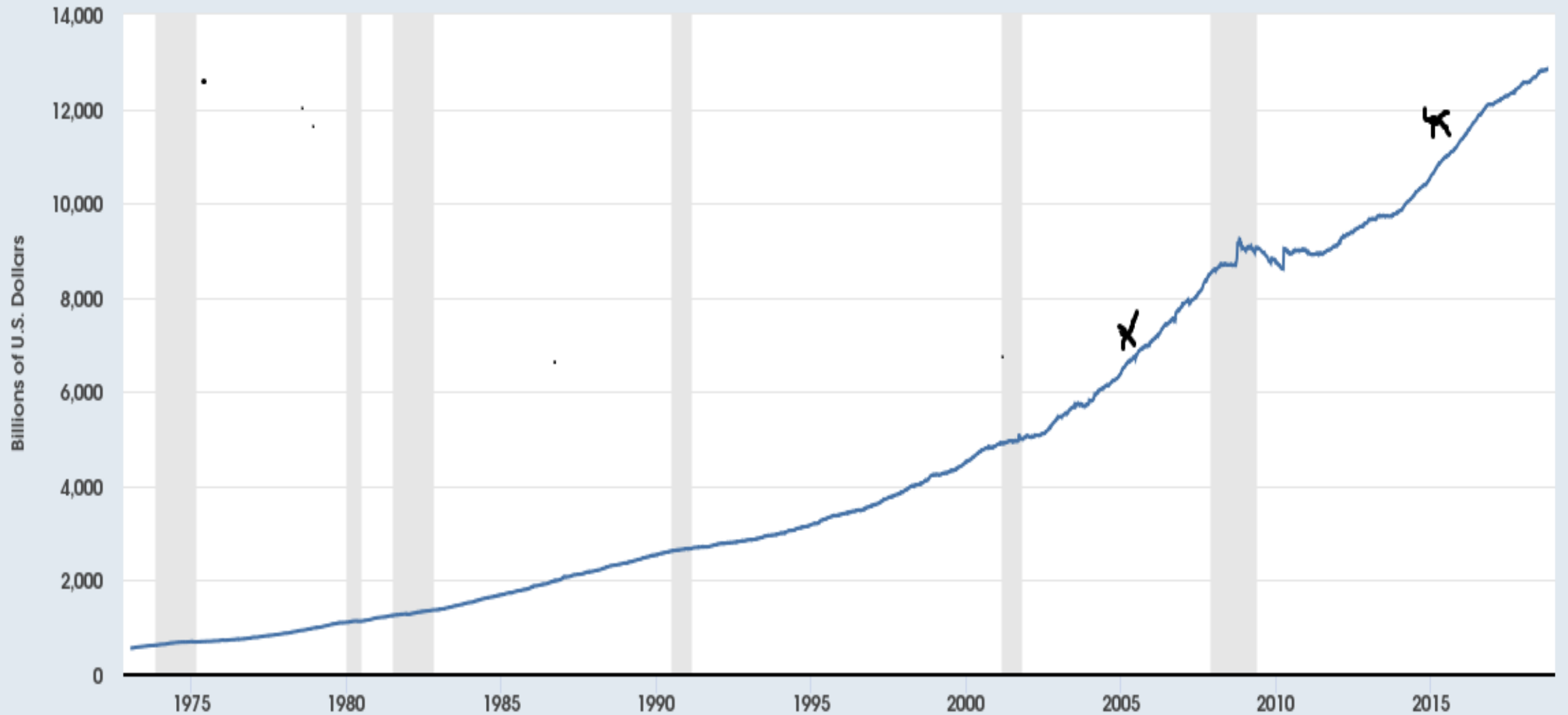
Key Counselors - Lender?

- Counsel from a lender on the front end is very cost effective, preferably not in the 9th inning!
- Good lenders do not charge for up front analysis. Beware of upfront “application fees” from mortgage brokers.
- Ask if your lender is a direct lender (versus a broker). Will this be a participation loan? Will this loan be sold?
- Recommended to get qualified / pre-approved for a mortgage before you get too far down the road with a realtor or architect.
- Banks can help you with a feasible debt capacity upfront.

- Many churches begin by spending countless hours and thousands of dollars in project design etc. before determining if they can “afford” the project.
 - Wastes precious time and financial resources.
 - Can result in unusable designs and plans.

Luke 14:28 “For which of you, intending to build a tower, does not sit down first and count the cost, whether he has enough to finish ... lest, after he has laid the foundation, and is not able to finish, all who see it begin to mock him, "saying, ‘This man began to build and was not able to finish.’”

Are Banks Lending and at what rates?



Shaded areas indicate U.S. recessions

Source: Board of Governors of the Federal Reserve System (US)

myf.red/g/IG9p

- U.S. Bank Credit went from approximately \$6 trillion in 2004 to \$9 trillion in 2009 (50% increase).
- Decline and Marginal Growth from 2009 to 2012.
- U.S. Bank Credit went from approximately \$9 trillion in 2012 to \$13 trillion in 2016 (44% increase).
- Banking industry and economy are generally healthy.
- July 2019 will mark the longest economic expansion on record.
- Translation: Economy doing well and Loans for Churches are readily available.

- However, Interest rates have increased.....

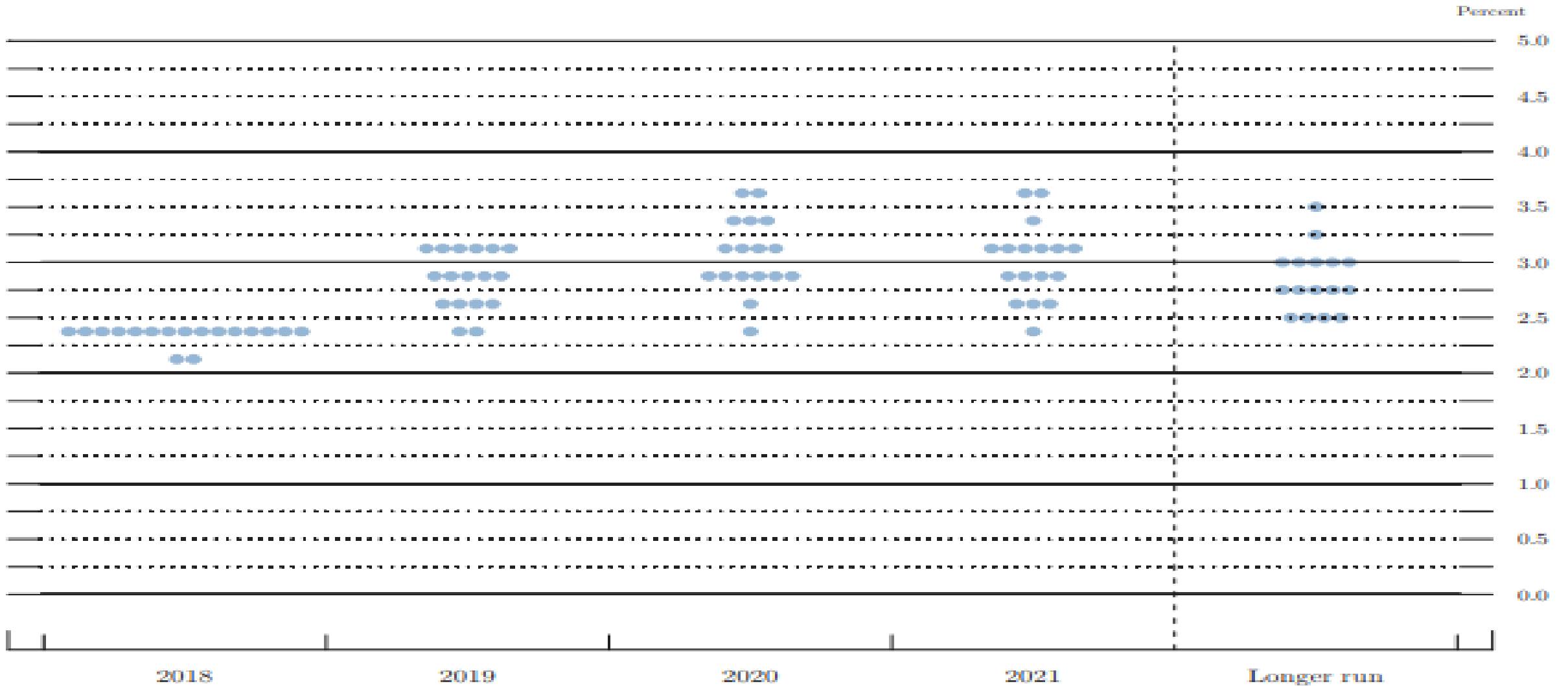
	<u>Feb. 2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>3 Year Change</u>
• Fed Funds Rate	.29%	.66%	1.42%	2.40%	2.11
• Prime Rate of Interest	3.50%	3.75%	4.50%	5.50%	2.00
• U.S. Treasury 5 Year Bonds	1.38%	1.93%	2.56%	2.51%	1.13
• U.S. Treasury 10 Year Bonds	1.97%	2.48%	2.78%	2.70%	.73

- **Where are Rates Going???**

- Source: Board of Governors of the Federal Reserve System, FedPrimeRate.com, and U.S. Department of the Treasury.

What is the Federal Reserve's "Dot Plot"

Source: Board of Governors of the Federal Reserve System.



What is the Federal Reserve's "Dot Plot"

- "Dot Plot" shows the interest rate projections of the members of the Federal Open Market Committee (FOMC).
- Each "Dot" represents a member's view of the range where rates should be at a given time.
- The graph represents the Federal Funds target rate. The FOMC sets this target rate. This has a ripple effect.
- Current "Dot Plot" suggests higher rates through 2020 and then perhaps stable or declining rate environment.
- Fed Meeting on January 30 vowed to be "patient"

Important Metrics to Consider

Sample Ratios – Cash Flow available to pay Debt

- Cash Flow available for Debt Service “CADS”
 - Measurement of the Church’s free cash flow to service proposed debt.
 - In For Profit world this is often called “EBITDA”.
 - Probably most important lending ratio and often overlooked by the Church.
- Impact on CADS from the following:
 - Rent Income – duration of lease and tenant.
 - Capital Campaigns – Ability to renew?
 - Non-recurring expenses – architect fees, fundraising consultant, etc..
- Weighting on historical cash flow rather than “build it and they will come”.
- Considered a Cash Flow Test that should be greater than 1.00 to 1.00
- Watch for Ongoing Covenants related to this ratio.

Great Blessings Income Statement–CADS to D.S.

Income:

Tithes & Offerings	\$1,000,000
Other	<u>50,000</u>
Total Income	\$1,050,000

Expenses:

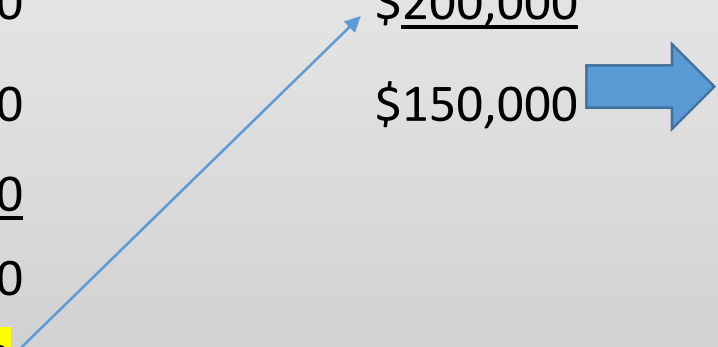
Personnel	400,000
Programs	200,000
Missions	100,000
Other (Utilities, Insurance, Etc.)	<u>150,000</u>
Total Operating Expenses	850,000
<u>EBIDA or CADS</u>	<u>200,000</u>
Depreciation	(75,000)
Interest Expense	(25,000)
Net Income	100,000

CADS Divided by Proposed Debt Service

\$200,000

\$150,000

1.33X



Sample Ratios – Required Debt Service to Giving

- Assessment of what percentage of Tithes and Offerings are Required to pay Debt Service.
- Considered a Leverage test.
- Should not exceed 30%.

Great Blessings Income Statement–D.S. to Giving

Income:

Tithes & Offerings	\$1,000,000
Other	<u>50,000</u>
Total Income	\$1,050,000

Expenses:

Personnel	400,000
Programs	200,000
Missions	100,000
Other (Utilities, Insurance, Etc.)	<u>150,000</u>
Total Operating Expenses	850,000
<u>EBIDA or CADS</u>	200,000
Depreciation	(75,000)
Interest Expense	(25,000)
Net Income	100,000

Proposed Debt Service / Giving

\$150,000

\$1,000,000 → 15%

Sample Ratios – Days Cash on Hand or Reserves

- Assessment of liquidity (cash and investments) available for operations. How many operational days of cash does the church have on hand?
- Only Unrestricted Cash – not funds restricted for Building or Specific Ministry.
- Should strive for target of 60-90 days.
- Debate on Cash On Hand versus Investing in Ministry.

Great Blessings Income Statement – Days Cash

Income:

Tithes & Offerings	\$1,000,000
Other	<u>50,000</u>
Total Income	\$1,050,000

Expenses:

Personnel	400,000
Programs	200,000
Missions	100,000
Other (Utilities, Insurance, Etc.)	<u>150,000</u>
Total Operating Expenses	850,000
<u>EBIDA or CADS</u>	200,000
Depreciation	(75,000)
Interest Expense	(25,000)
Net Income	100,000

Unrestricted Cash / ((Operating Expenses + Proposed Debt Service) Divided by 365)

$\$100,000 / ((850,000 + 150,000) / 365)$



36.5 Days Cash on Hand

Sample Ratios – Giving Per Attendee

- Measurement of Annual Giving Per Attendee.
- Potential Indication of Income (and possibly age) demographics.
- \$1,500 to \$2,000 per attendee annually is considered good.

Great Blessings Inc. Statement-Giving Per Attendee

Income:

Tithes & Offerings	\$1,000,000
Other	<u>50,000</u>
Total Income	\$1,050,000

Expenses:

Personnel	400,000
Programs	200,000
Missions	100,000
Other (Utilities, Insurance, Etc.)	<u>150,000</u>
Total Operating Expenses	850,000
<u>EBIDA or CADS</u>	200,000
Depreciation	(75,000)
Interest Expense	(25,000)
Net Income	100,000

Annual Giving / Adult Attendance

\$1,000,000

500



\$2,000

Sample Ratios – Amount of Debt to Giving

- Assessment of the Loan amount to annual level of Tithes and Offerings.
- Considered a Leverage test.
- Should not exceed 4 X, preferably 3 X.

Great Blessings Income Statement – Debt to Income

Income:

Tithes & Offerings	\$1,000,000
Other	<u>50,000</u>
Total Income	\$1,050,000

Expenses:

Personnel	400,000
Programs	200,000
Missions	100,000
Other (Utilities, Insurance, Etc.)	<u>150,000</u>
Total Operating Expenses	850,000
<u>EBIDA or CADS</u>	200,000
Depreciation	(75,000)
Interest Expense	(25,000)
Net Income	100,000

Loan / Annual Giving

\$2,000,000

\$1,000,000

➔ 2X

Other Sample Ratios -

- Debt per Attendee
 - Another leverage test.
 - What is the debt burden when distributed over all attendees?
 - Should be less than \$7,000 per attendee
 - Great Blessings Debt: $\$2,000,000 / 500$ attendees = \$4,000
- Loan to Value Factors to Consider
 - Loan to Value ranges are generally 70% to 80%.
 - Can you borrow against other property?
 - How will the appraiser look at renovation cost?
 - Appraisals are Fair Value, not Replacement Cost.

Strategies for Success in Obtaining a Loan

- Google your Church and Pastor
 - If there are negative results, should a lender be concerned?
- Evaluate Attendance trends
 - If flat or down, is this due to staff transition, online attendance, church plant or other?
- Is there a Pastoral Transition Plan Now or Future?
- Board members – who is on the Board? Is the Board considered independent?
- Key Donors – Is there concentration of giving?
- Have Good Data on Capital Campaign (amount pledged, given to date, key donors)

- Prepare an Operating Budget with Projections

Many churches budget for “net zero surplus” “We’re a non-profit”

- It is highly recommend to regularly budget for surpluses to:
 - Build adequate cash reserves
 - Provide sufficient cash flow for debt service
 - Provide excess cash flow for accelerated principal reduction.
 - Provide for capital replacement projects and maintenance.

- Hire a CPA
 - Good financial reporting provides the basis of sound decision making.
 - “GAAP” Financial Statements translate your church financial statements to an industry recognized language.
 - Consider Compilation, Review or Audit with accompanying footnotes. What does this cost?
 - Outside Financial reporting signals strong accountability, transparency and leadership.
 - Consider ECFA Certification?

Can Great Blessings Borrow \$2mm???

Summary of Ratios:

- CADS to Debt Service Ratio = 1.33 to 1.00
- % of Debt Service to Income = 15%
- Days Cash on Hand = 36.5 days
- Giving per Attendee = \$2,000 per attendee
- Debt to Income = 2 Times
- Debt per Attendee = \$4,000
- Loan to Value = Ok

Can Great Blessings Borrow \$2mm???

- Consider timing of pledge collection. Might they need more than \$2mm in the short term?
- Run a few debt scenarios at \$2.5mm, \$3mm, etc.
- Banks can help with this analysis.

Questions?