



CHURCH

FINANCING

Two Key Requirements to Qualify

By

Stephen Anderson

The Rules Have Changed, Are You Prepared?

Church projects across America are coming to screeching halts due to difficulties in obtaining financing. Many of these churches have not adapted to the new church lending paradigm that has come into effect since last fall. Church lending has become a whole new game, but most of the church players are not learning about the rules until they show up to play, only to find they are ineligible don't meet the criteria and are.

Intellectually, churches understand lending has become more difficult, but what many do not realize is it may take a year or more to correct the issues that are preventing them from qualifying for the loan they need today. The lending environment has not just become more difficult, it has fundamentally changed from a year ago.

Many of the church lenders from 2008 are no longer making loans, either because they no longer desire to be in the church lending market, or in the case of some church specific lenders, because they

have no money to lend. Some lenders will admit up-front they no longer make church loans, others set the bar for qualification so high it is constructively the same thing as not lending to churches.

New Wine in Old Skins

The reasons or justifications lenders provide as to why they no longer make church loans are unimportant, as the effect is the same – fewer places to find money with which to build. For those lenders still lending to churches, the old rules churches have come to understand and expect are essentially out the window, having been replaced by fewer sources of money, new levels of documentation, and much stricter underwriting criteria.

The scriptures warn about trying to put new wine in old skins. The old wine skins would burst under the pressure of the new wine fermentation process. Likewise, if churches approach lenders today with the same expectations and qualifications

as last year, their bubble will burst as well. To keep the church's hopes and plans from bursting, their borrowing approach needs a new skin, that is, a new level of preparation and presentation.

Out with the Old and In With the New

It's important to understand how lending has changed in the past year. A year ago, a church might expect to borrow as much as 80% of the project value (Loan to Value or LTV). They could often qualify for a loan amount not to exceed four times its current income in tithes and offerings, or with a loan payment not more than 35% of its income, whichever was higher (which was a factor of the interest rate and term).

If the church's loan payment was estimated at \$10,000, the lender would want to understand how the church would make the payment from their cash flow. Since most churches do not have an appreciable monthly net positive cash flow, the church and the lender would look at expense items in the budget, and if sufficient discretionary expenses were found which the church was willing to trim to make the mortgage payment, the lender would generally approve the loan within guidelines above.

This is a crucial point: the church did not need to demonstrate a net positive cash flow; it just needed to show how it could adjust the budget in order to service the debt. The net result was that the church could get 80% of the completed value of their project as long as the other conditions were met.

Today, the picture is much different. Aside from a higher degree of documentation regarding the finances of the church, the two biggest changes are to be found in the calculations for LTV (percentage of the project cost the lender is willing to loan), and the net income with which to service debt. Today a few lenders are still loaning 80% of the project costs, but many have dropped to only 70% or even 60%.

This means a church with a \$1M building project may only qualify for a loan of \$600,000 or \$700,000, as opposed to \$800,000 (or sometimes more) last year. For this church to build this project now means it will need to raise an additional \$100,000 to \$200,000 in cash in order to build the

same project. The only options churches have are: raising more cash, reducing the scope and cost of the building program, or not building.

In addition to needing to raise more cash before beginning their building program, churches face another serious challenge. Most lenders today will accept, in faith, the church's intent to cut expenses in order to service the debt. Consider the example of the church with a \$10,000 per month estimated mortgage payment.

Instead of agreeing upon how the church would make future budget changes in order to service the mortgage payment, the lender will require a history of retained earnings that are 110-120% of the payment amount. They want to see this amount on the bottom line of the income and expense report, and they want to see it for at least the previous 6-12 months. As John Bernadino, VP of Commercial Lending at Griffin Financial put it, "Cash flow is king and cash on hand is queen; and together they rule."

The church that is looking at a potential \$10,000 per month loan payment will, in many cases, need to show that they have had income in excess of expenses of approximately \$12,000 per month, for the past 12 months. This is very bad news for the church that is trying to get lending for a building program that is needed now.

The Challenge

Today, when the church applies for a loan, it generally needs to be able to demonstrate two important qualifications. First, a history of retained income in excess of the loan amount, and secondly, sufficient cash to bridge the widening gap between the loan amount and the project amount. If the church approaches a lender with financial reports that do not demonstrate these two fundamental requirements, they are extremely unlikely to get funded.

The sad probability is, if the church had approached the lender a year ago with the same financial reports, they probably would have been welcomed with open arms and a loan commitment, but those days are gone. This bad news is also true for churches that received a loan commitment last

year and did not close on the loan, for whatever reason. That church, even with a commitment letter in their hand, may find that the lender no longer makes church loans, or that the underwriting criteria has changed so much that the church cannot qualify for nearly the same loan. What makes all of this even more serious is it may take the church a year or more to demonstrate a net cash flow and cash on hand to qualify for the loan they require from the time of the rejection.

The Solutions

For the church that has just received a rude awakening from a lender, or is about to, there is perhaps little that can be done in the short term, as the lender needs to see a history of the church being able to afford the loan. Less serious is if the cash on hand is too short, it takes time to raise money, as money can be raised faster than creating history. The remedy for these churches is the same as the strategy for the churches which will be looking into the future; they need to implement a few financial strategies ASAP. Ideally the church will apply these following strategies at least a year before they approach a lender.

To increase cash flow, the church has only three options: Reduce expenses, increase giving, or a combination of the above. The first thing that any church can do, and they can implement this immediately, is to begin to reduce expenses. Having been through this exercise in my own church, I can attest it is neither easy nor fun, but it is doable. Often times, the longer a church has been in existence, the more room there is to cut. This is due to the simple fact that over the years and decades, things creep into the budget that never seems to creep back out. Some people's pet programs will have to run on reduced budgets or even be cut entirely.

This is a great time to honestly and objectively evaluate what programs and expenditures are producing fruit in keeping with the vision and mission of the church, and cut out those that are not productive. Even cutting back in productive areas can be a good thing. The Bible speaks of dressing the vines in order to achieve a bigger harvest the next year. Programs and ministries that take a short term cut will often receive more funding over a 10 or 20-

year period if the church grows.

Be prepared to look at the big picture when considering budget cuts and consider what can happen in these programs if you church attendance and income grows significantly. One way to begin expense cutting is to implement reductions in discretionary expenses pretty much unilaterally across the board by a given percentage, and then adjust the reduction or even eliminate funding for programs that are not being directly and demonstrably effective in accomplishing the mission of the church. Of course, for this to be effective, you must have a crystal clear understanding of what your core mission is.

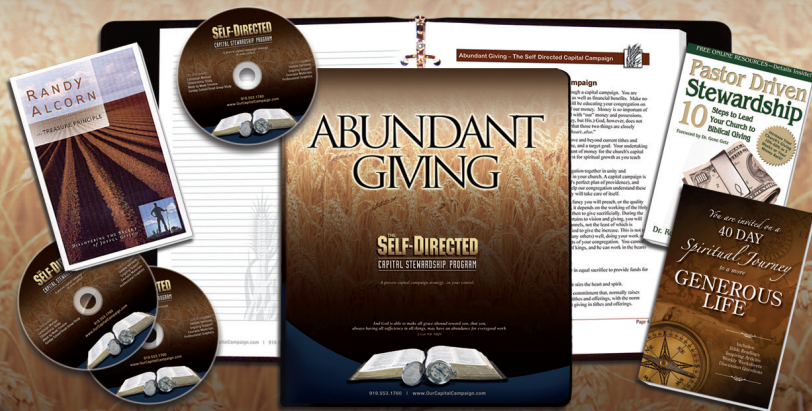
Increasing giving is a bit more complicated, but will almost always result in more of a net change than cutting expenses, and of course the maximum advantage is when you pursue both courses of action. Churches who get serious about teaching and preaching on Biblical giving in clear and unequivocal terms, see dramatic increases in giving.

As pastor, consider breaking away from your current sermon series and implement a multi-week time of preaching and teaching on stewardship as soon as you can. Many churches which not only teach, but call/exhort/challenge their people to action see increases in giving of 10-30% in a matter of weeks. As the church reduces expenses and increase giving, that money should to be put into the building fund to address the other major stumbling block to qualifying for a loan: adequate cash on hand for building.

In addition to the short term, quickly implemented solutions above, an important long term strategic solution is to implement a church capital campaign. A capital campaign is a time-proven solution to address both monthly cash flow and cash on hand issues. Even in these difficult economic times, a capital campaign will normally raise between 1-3 times the church's current annual budget over three years.

A church with a \$250,000 annual budget can reasonably expect to raise \$250,000 to \$750,000 over a 3-year period, with about 40% or more of that received within the first year. As a capital campaign consultant, I can attest to both the spiritual and financial fruit produced by a capital campaign.

A Complete Church Capital Campaign In A Box



Planning a Fall Campaign?

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Our capital campaign results have historically raised an average of approximately 2-times the church's current annual tithes and offering from a campaign, and continue to do so, even in these difficult times. Additionally, churches typically experience an increase of 10-15% in regular tithes and offerings in addition to the money raised for the building fund.

Bottom Line

If you have already received bad news from the lender, you now have a plan to reverse that decision. If you expect to approach a lender anytime within the next one or two years; you know what you need

to do starting today. Regardless of whether the lender visit is in your past, or your future, you need to cut expenses and almost certainly start a capital campaign as quickly as possible.

Stephen Anderson is the founder and principal church building and capital campaign consultant for AMI Church Consulting. His church leadership experience includes serving as church administrator, church treasurer, building committee chairperson, and capital campaign chairperson. He is also the author of the book, *Preparing to Build*, and the *Abundant Giving* capital campaign program. For more information, visit www.amiccs.com.

