Loan Discussion Quicksheet for Presbyteries

Partnering with Congregations and Presbyteries to evaluate project feasibility

- **Creates Self-Discovery Process For Exploring Project Feasibility**
- **Identifies Key Factors For Discussion**
- **Compares Project To Acceptable Norms**

Presbyterian Church (USA)

Investment & Loan Program Inc.

GUIDELINES FOR LOAN DISCUSSION

Changes in our denominational landscape have heightened concern among presbyteries about approving congregation requests to borrow money. Congregational leaders are more cautious of taking on expansion projects that could negatively impact their mission and ministries. Everyone seems to be searching for a reliable process that will help them assess the feasibility of projects — a tool that will add consistency to the way they evaluate requests to borrow funds.

For years PILP has been helping churches evaluate their capacity to fund projects before they get to the application, and hopefully before they get too far along the project design phase. The process, called a "Preliminary Look", shows output of the analysis and demonstrates to church leaders how their proposed financial plan compares to three norms of successful projects.

Building on this experience, we have developed a guide for presbytery committees to use when evaluating church requests to borrow money. Though not intended to provide a complete underwriting of the loan, this process analyses key variables to a successful project.

A Process of Self-Discovery Works Best

Loan discussions are most effective when approached as a process of self-discovery where both the church and the presbytery explore the relative strengths and potential challenges of a loan. The outcome should be a greater understanding of the implications and risks of taking on the requested debt level and a joint decision about how to proceed.

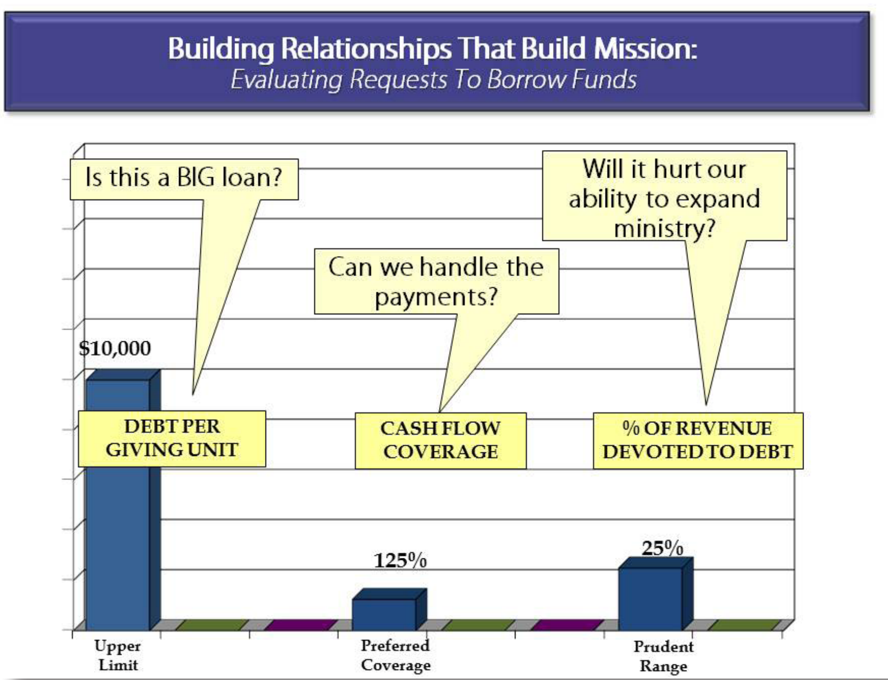
Focus on the Critical Questions

How much money will they need to raise? How many consecutive campaigns will be required to pay off the loan? Will they have the cash flow to safely make the payments? Will the debt load have a negative effect on current and future ministry plans? Church leaders can get a snapshot of how much debt they could handle (debt capacity) and how much debt they would consider comfortable (debt tolerance).

A Partnership Approach

After these discussions, church leaders have the confidence to move forward or realize the need to revise their plans to a more comfortable level. A *good* loan may indeed have good numbers, but good numbers are a function of a good plan. Helping churches articulate and improve their plans is the best service we can provide.

Again, we highly recommend that the evaluation process be approached as a discussion and partnership with the church rather than a critique. The presbytery's committee can act as another set of eyes to help the church leaders validate or revise their plans.



INTERPRETATION AND DISCUSSION GUIDE

What are the most important factors to discuss?

Debt Per Giving Unit (DPGU)

Debt per giving unit is calculated by dividing the total debt of the church by the number of giving units in the church (total potential giving units, not just the number that give). When the number of giving units is not readily known, dividing the membership by 2.2 provides a good estimate of the potential giving units.

This factor is a measure of the size of the loan relative to the size of the church. It helps the church leaders understand whether this loan would be relatively easy to take on or might present future challenges. A debt per giving unit of $10,000 is considered to be a very large loan and potentially risky for the church. A loan above $10,000 per giving unit may be acceptable, but there must be mitigating factors like a strong capital campaign that would bring the loan down to an acceptable size within a few years.

What are the risks associated with a high Debt Per Giving Unit?

•The potential discouragement associated with years of debt payments can create fatigue and very high debt can be a deterrent to attracting new members. The average church loan is repaid in 11-12 years. For most churches that would require running about 3 consecutive three-year campaigns. With very high DPGU loans, the church may be faced with running consecutive campaigns for the full 20 years of the loan which can affect the church's ability to raise funds for other ministries.

•If the DPGU is below $10,000 but still significantly high, consider any signs of instability that could negatively affect the membership and giving. Compare the trends of membership and worship attendance relative to other churches in your area. If there is a sudden loss of membership, a once acceptable level of debt could become a great burden on the remaining members.

•Another item to review when the DPGU is significantly high is the strength of the capital campaign relative to the normal pledge giving. If the church has run a campaign with the help of a professional firm, you would expect a successful campaign to yield pledges equal to about 2-3 times their pledge budgets. If church ran an internal campaign (without professional help), typically pledges will equal 1.0 to 1.5 times the pledge budget. Capital campaigns that fall short of these averages could indicate a lack of broad support for the project. If the campaign is significantly below average, you may want to ask what percent of the membership voted in favor of the project. If below 80%, this could be a concern. *(In the case of small projects that are limited to repairs or replacement of equipment, you would not expect the pledges to reach these norms).*

DISCUSSION QUESTIONS

- How do you plan to pay back the loan?
- Will you run a capital campaign, and if so will you use a professional campaign firm?
- How long do you think it will take to pay back the loan?
- How many capital campaigns will it take?
- Is the congregation aware that several capital campaigns may be necessary?
- (If the DPGU is high) Is it possible to do the work in phases that will enable you to spread the debt over time?

INTERPRETATION AND DISCUSSION GUIDE

Cash Flow Coverage

Cash flow coverage is calculated by taking the amount of money available to make the payments divided by the annual debt payments. If there is a capital campaign, it is assumed that the payments will come from those pledges and not the annual operating budget. If there is no campaign, typically there will be just enough funds available to make the debt payments. If there is no capital campaign, be sure to check the third factor (% of Revenue Devoted To Debt) very closely. If this third factor is more than 12%, then the debt payments could have a very detrimental effect on the church's mission & ministry budget.

We recommend that the church have 125% or higher cash flow coverage. That is, they will have 25% more money coming in to pay debt than the actual debt payments. Why 125%? First, pledge fulfillment of capital campaigns does not come in evenly each month. They tend to be skewed to the beginning of the year and the end of the year. 125% coverage will give the church extra funds to cover the payment during the leaner fulfillment times. Secondly, with 125% coverage, the extra revenue will allow the church to repay the loan earlier and save on interest expense.

What are the risks associated with low cash flow coverage?

•Obviously, if the ratio is less than 100%, then the church will not have the funds to make the loan payments. In cases where there is a capital campaign, they may need to reserve more from the campaign funds to pay debt and borrow more than projected.

•If the ratio is between, 100% to 110%, then the church's operating budget may need to be tapped when the capital campaign pledges are not flowing in on time. Unfortunately, this would normally occur during the summer months when most church's revenue is tight to begin with. A possible mitigating factor would be the ability of the church to tap into reserve funds until the pledges are fulfilled. Dividing the reserve funds by the monthly debt payments will give you an idea of how many months the church could cover while waiting for capital campaign funds to come in.

•Ratios beyond 125% will give the church the ability to make additional principal payments and shorten the life of the loan.

DISCUSSION QUESTIONS

•(If cash flow coverage is below 100%) "Your monthly debt payments will be more than the money you have available to pay them. What is your plan to make up the difference?" If the answer is to ask members to increase their pledges to the operating budget, you might want to ask: "What % increase in the budget will you need and what would the dollar amount be?"

•(If cash flow coverage is 100% to 115%) "It does appear that you have the cash flow to make the payments, however, it is tight. What is your plan for making the payments if and when the pledge receipts are below expectation?"

•(If cash flow is above 115%) "You should have more than enough cash flow to make the regular payments. Do you have plans to put some of the annual excess against the principal balance of the loan and pay the loan off earlier?"

INTERPRETATION AND DISCUSSION GUIDE

% of Revenue Devoted to Debt

Percentage of revenue devoted to debt is calculated by taking the annual debt payments and dividing it by total annual revenue of the church (operating revenue plus the amount of capital campaign pledges they expect to receive annually). If the debt is to be paid from capital campaigns, we would prefer this percentage not be more than 25% to 30%. If the debt is to be paid out of the operating budget, we do not recommend more than 10% to 12% of the total revenue going to debt payments.

What are the risks associated with a high % of revenue devoted to debt?

•As the debt payments exceed 30% of the revenue (12% without a capital campaign) the church will definitely feel the pinch on their budget and it will limit their ability to expand other missions and ministries. New buildings and improvements can help churches meet new ministry needs of their community as well as attract new members. However, if the debt payments take up too much of their revenue, the church may not be able to expand ministries and programs to take advantage of the new space. It may also hamper their ability to increase staff to accommodate the increase in membership or programming.

•As the percentage approaches or exceeds 30%/(12% with no campaign), you would want to determine if the church is already "program rich" and will not need to expand programs in the near future. Also, you would want to feel comfortable that the current staffing levels would be able to accommodate growth in programs and membership. Otherwise, the increased workload could lead to burn out of the staff.

DISCUSSION QUESTIONS

• *(>30% with a capital campaign/>12% without a campaign)* "The debt payments on your loan will be about XX% of your whole revenue stream. Normally, when the debt payments are in excess of 25%-30% of the revenue, churches will find it difficult to create new programs or add staff during the life of the loan. Do you expect to create new programs in the future? Could you expand programs and ministries with the current staffing arrangement?"

• *(>12% paid from regular operating budget)* " The debt payments will account for XX% of your annual operating budget. Most churches whose debt load exceeds 12% of their budget find it very difficult to expand mission and ministry and often have to make cuts to staff and programs. What would be your plan if you start experiencing budget shortfalls?"

Side Note Regarding Capital Campaigns
Some churches are reluctant to run capital campaigns. They would prefer to find a way to pay the debt out of the operating budget or reserves. While small loans may be safely paid from the budget, larger loans typically cannot. Often churches will just depend on an appeal for members to increase their giving to the operating budget. Seldom does this low-key appeal bring in enough to make the payments, especially if the additional giving represents an increase in the budget of more than 10%. Most members view giving to the operating budget differently than giving to a special campaign. We look at our operating budget pledges as what we can afford to give out of our disposable income while capital campaign pledges are viewed as gifts from our accumulated assets. Almost without exception, a separate capital campaign will deliver more total funds than a simple request to increase regular pledges.

INTERPRETATION AND DISCUSSION GUIDE

Other Considerations

Membership and Worship Attendance Trends
Have there been significant changes in the church's membership and/or worship attendance that might be indicative of growth or decline? Ask the church to identify what factors are influencing their growth (decline). A dramatic drop in worship attendance could be a sign of future instability. However, churches normally see small drops in attendance when there is a pastoral transition.

Annual Surpluses/Deficits In Operating Budgets
What has been the church's financial trend? Has giving to the operating budget kept up with expenses? Are they running surpluses or deficits? If they have been running deficits, is there a plan to bring revenues up or expenses down? If the trend is a series of deficits, how have the deficits been covered and is the congregation fully aware of the situation?

One thing to watch for in the church's financial reports is "transfers" from reserve accounts that are reported as income. Sometimes churches will "balance" the budget by transferring funds from reserve accounts to offset losses. We prefer to restate the financial statements where income and expense statements are "free" of transfers. This will give the most accurate reflection of actual revenue and expenses. It is not uncommon for revenue taken in one year to be spent in a following year, especially in the case of special mission projects and appeals.

Reasons to PARTNER with Presbyterian Investment & Loan Program

- **LOW** base loan rates generally below those offered by commercial lenders.
- **NO origination fees** or points that can drive up the cost of a loan.
- **NO pre-payment penalties** should you wish to make principal payments ahead of schedule.
- If your loan includes investor funds, you can **QUALIFY FOR REBATES** of the interest paid on the investor portion of the loan.
- **FREE analysis** called a *Preliminary Look* that can help you discern how much debt your church can prudently take on.
- A **KNOWLEDGEABLE, caring staff** with over 100 years of collective experience, here to help your session navigate the unique process of congregational and presbytery approvals.
- The program is managed by a **DEDICATED BOARD OF DIRECTORS** comprised of Presbyterians from across our denomination.
- Interest you pay on your loan will HELP OTHER PRESBYTERIAN churches expand, renovate, and reshape their ministries.

TYPES OF LOANS

Loan funds may be used to finance or refinance capital projects such as new buildings, additions, expansions, remodeling and repairs. Loans are also available for the purchase of new sites, as well as adjoining land.

Building Loans

Funding can be set up as a typical construction loan which rolls over to permanent financing at the end of construction. We can also provide permanent financing, bridge loans, or we can refinance/consolidate your existing debt.

- Loans may be amortized for up to 20 years.
- The interest rates are adjustable. On loans that utilize investor funds, rates are adjusted to the prevailing base rate every three (3) years. For loans funded exclusively through endowment funds, the rates are fixed for five (5) years.
- The interest rates on investor funds are generally set based on trends in the Program's cost of funds (i.e. trends on average rates paid to our investors).

Construction loans
On loans that utilize investor funds, construction draws are available. You pay "interest only" until the project is complete at which time the loan becomes a regular amortizing loan.

Site Loans

As with building loans, site purchase loans are generally "first lien" mortgages.

- Loans may be amortized for up to 20 years.
- Endowment fund limitations – To use endowment funds, the total amount borrowed from all sources should not exceed 80% of the purchase price.
- Investor fund limitations – Investor funds may only be used for the purchase of sites where construction will begin within six months.

REFINANCING/LOAN CONSOLIDATION

Refinancing of existing mortgages and consolidation of loans are also available through the investor funds.

Incentive Loans

Special incentive loans with favorable terms are also available:

Manse Loans
- Up to $100,000 loan for the purchase, repair or renovation of manses used for pastor housing.

Maximum loan term is 15 years and the interest rate is the same as the prevailing Church Loan Program rate.

Disaster Relief Loans
- ***Must be in an area declared as state or national disaster.*** Rate is 2% below prevailing Church Loan Program rate for first five years and will receive the prevailing discount for an additional 5 years.

NEW

Energy Conservation
The new ***Restoring Creation Loan*** is available to qualifying congregations engaged in projects that purposefully render our churches more energy efficient. With discounted interest rates and flexibility in loan terms, congregations will be encouraged to renovate their buildings using energy efficient products.

(visit www.pilp.pcusa.org for more details)

For More Information Contact your Regional Representative

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E-Mail: loan.help@pcusa.org
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PRESBYTERIAN CHURCH (USA)

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