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Church Mortgage Refinancing Forum

A *Church Executive* Forum

Presented by:
Bank of the West Religious Institution Banking, BCLC Church Lending & Thrivent Church Financing

Table of Contents

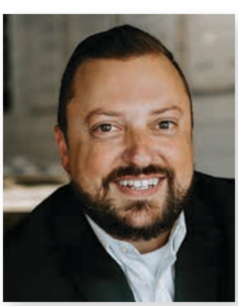
Church Mortgage Refinancing Forum

What got you here, won't get you there...

When I was growing up in a pastor's home, I remember the building fund appeals and public declarations of how much we had raised for the new sanctuary. I remember watching the magic of construction progress over the next few years.

Behind the scenes, however, there were meetings with bankers, bond brokers, and large donors — but all of that was invisible to me. I just thought we raised all the money and then built a building.

Simple! *Right?*



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Fast forward some 30 years, and most of your congregation probably has a similar view of the construction process: raise funds, build the building. While it has never been *that* simple, the reality today is that even the "normal" processes of the past won't be sufficient for the future.

Tomorrow's church will be energized — or restricted — by the facility decisions you're making today. If you choose to build a single, large structure with long-term financing today, you're setting up a direction for the future of your church. Conversely, if you opt for smaller or more varied incremental projects, you're also setting a direction.

What's happening *now*

As we look to the facility and financing trends of 2023, four obvious signs are emerging:

#1: Single, large rooms limit options

The days of 5,000-seat auditoriums being built as the final of four onsite phases of expansion on a 50-acre site seem to be behind us. Instead we're seeing churches build more 500- to 1,000-seat auditoriums for multiple campuses.

Multi-use has been on the rise for a long time, and the past few years have accelerated the trend. Today, churches like to be able to add or remove chairs, change the room format, and use facilities for a broader set of ministry and community activities.

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#2: Flexibility and technology are key

While ornate design hasn't been popular in a long time, the trend in facility investment has definitely moved increasingly towards flexibility and a heavier investment in technology, video, and sound and broadcast quality.

#3: Financial stewardship is still important

Good financial management has always been valuable for the Church; it's essential if you want to sustain long-term church growth and effectiveness.

Having good financial leadership *in* the church is just as important as finding a good financial partner *outside* the church to work with on projects and ongoing needs. To this end ...

#4: People matter — staff included!

While there are still churches which benefit from the single financing transaction, the number of churches which can benefit from a comprehensive financial plan and strategic banking relationship with seasoned experts is growing.

Gone are the days where the local bank can meet every need for a ministry that's rapidly expanding and meeting community needs. Like any "industry," there are a few seasoned veterans in the church finance space who can add value and help take a ministry further, faster.

In the end, the Church will thrive if we involve the right experts and push hard to reach people in new and creative ways, while never forgetting that we have the Hope the world is searching for. CE

Church Mortgage Refinancing Forum

Show me the money!

Borrowing-capacity tips for churches

Before you talk with any lending group, your church will need to fully understand the ups and downs of its last three years of financial statements. Church lenders will always focus on undesignated income, cash flow, debt and equity trends.

The first thing *churches* really want to know, however, is their borrowing capacity.

Gerald R. James, Jr.
President / CEO
BCLC Church Lending

Determining this capacity isn't that complicated

The simplest approach is multiplying last year's annual undesignated income by three. For example, if a church multiplies its $100,000 in annual undesignated income x 3, then that church could possibly borrow up to $300,000.

Here's another borrowing capacity ratio that will help you out. First of all, make sure that your church's loan payments do not exceed 25% of your annual undesignated receipts. A $300,000 loan — at a five-year fixed rate of 4.25%, with a 20-year amortization — has an annual debt service of $22,292, or 22% of annual undesignated receipts.

If you keep the debt payments under 25%, you should have sufficient income, assuming your remaining expenses don't get out of line with your church's budget.

What's in your budget?

As we all know, Coronavirus caused some churches to struggle financially during the last three years. However, most of the mission-minded churches we serve generated *increases* in undesignated receipts and cash flow. Most of these mission-minded churches continued to support their local ministries throughout the pandemic. During this time period, they also paid down their debt at an accelerated pace.

Mission-minded churches and mission minded lenders can accomplish a lot.

There are many ways to break down a church budget. The most efficient way to make sure your church is financially healthy is with a Fixed Expense Ratio. Simply divide annual undesignated receipts by salaries, projected debt payments and utility expenses. For example, let's say that a church has annual undesignated receipts of $100,000. Salaries — plus debt payments and utilities — should not exceed 75% to 80% of undesignated receipts.

The reason the Fixed Expense Ratio is so important to your church is because it allows room in the budget to help other ministries. As mentioned earlier, churches that are committed to supporting ministries are generally healthier than churches that aren't mission-minded. The primary reason for this is because your strong tithers really like to financially support your ministries.

> **"Before you fall in love with the interest rate, make sure you understand the closing costs and the terms of your future loan."**

How important is the interest rate?

One of the most-asked questions by churches seeking loan funds is, *What's the interest rate?* Most church lenders and banks base their interest rates on the cash flow and equity of the church. Cash flow provides the funds necessary to service the debt, and equity allows the lender to sleep better. Stronger churches sometimes have lower interest rates than financially challenged churches.

Before you fall in love with the interest rate, make sure you understand the closing costs and the terms of your future loan. Closing costs include title work, legal fees, survey, appraisal, and an origination fee from the lenders. Most of the time, your lending source will expect your church to pay most of the closing costs. On some occasions, they will pay for a portion of the expenses. Make sure your lender provides an estimate of closing costs before your church signs anything.

Should your church accelerate debt reduction?

Debt reduction is a great way to create more room in your budget for future building projects. If your church isn't interested in any future building projects, most lenders will allow you to amortize your debt up to 20 years.

Whether your church reduces its debt or not, it is always wise for churches to designate funds for repairs and maintenance. In our practice, the average loan payoff for church lending portfolios is eight years.

Before you seek a loan, be sure to keep all these borrowing-capacity tips in mind. It's just good stewardship. CE

Church Mortgage Refinancing Forum

Refinancing in a rising-rate environment

For the past 14 years, we've been experiencing near-historic low rates, and it appears those days might soon be gone as rates have risen over the past several months.

The wonderful news? Many churches were able to take advantage of the low rates either by refinancing, purchasing a new property, or renovating or building a new sanctuary to expand their ministries' reach within their communities.

David Lee, Sr.
Senior Relationship Manager
Thrivent Church Financing

Difficulties and challenges have never deterred churches from pressing towards Christ's call "to go and make disciples of all nations, baptizing them in the name of the Father and of the Son and of the Holy Spirit." (Matthew 28:19) Rather, churches have always adjusted, become more creative, resilient and determined. We don't need to go back further than March of 2020 and the onset of the pandemic to be reminded of this.

Rising interest rates are simply another hurdle that we all — including us, as church leaders — will have to adjust to. This might include having to refinance your church loan earlier than planned — there might not be an alternative. The subject of refinancing has typically been reserved for when borrowers are looking to lower their interest rate and save money; however, there are situations which warrant refinancing at higher rates; here are a few of them:

RATE ADJUSTMENT/RESET

Carefully review your loan documents to see if your loan has an upcoming rate adjustment or rate reset in the next several years, as well as its frequency. If your rate adjustment is occurring every three to five years, you are exposing your loan balance to paying higher interest if rates continue to rise at every reset period. For every 1% increase in your rate, your ministry could be paying an additional $10,000 in interest annually for a $1-million loan balance that could otherwise be reinvested back into your ministry programs. Just imagine how many additional missionaries your church could support or how many youth you could send to summer camp on scholarship!

One way to mitigate this risk is to find loan options that can reduce or eliminate the frequency of adjustments through longer terms (10-, 15- or 20-year fixed rates) or with fully amortized loans.

LOAN MATURITY/BALLOON

Again, review your loan documents to see if your loan has an upcoming maturity or balloon; this is typical for most church loans. If your loan is maturing in the next one to three years, you will have to refinance upon maturity. So, in a rising rate environment, it might make sense to refinance *prior* to your maturity date, even though it might mean you're refinancing at a higher rate.

Before you do, be sure to check if your loan has any prepayment penalties or SWAPs tied to it, as this could factor into your decision. Most traditional church lenders will have a loan term around 10 years; so if your loan was amortized over 20 or 25 years but has a term of 10 years, the remaining outstanding loan balance at the end of the term is due in full. Unless you have the cash to pay off the outstanding balance, your ministry *will* have to refinance at the end of the 10 years or term period at the prevailing market interest rate, resulting in your church needing to requalify and incur additional fees (loan origination, appraisal, title, and so on). One way to mitigate this exposure is to find lenders that offer, long-term fully fixed rate loans with competitive rates and fees.

Refinancing at higher rates really has one primary objective: to reduce interest rate exposure for the church — which is still very much a stewardship decision. Although this might not be the most popular and well-received topic at your next board meeting, it just might be at the top of the list before rates increase even more.

"For every 1% increase in your rate, your ministry could be paying an additional $10,000 in interest annually for a $1-million loan balance that could otherwise be reinvested back into your ministry programs."

GET AHEAD OF THE CURVE

It's wise to be proactive in managing your loan decisions rather than waiting for an event to force your church to respond. As we emerge from the COVID-19 pandemic, we've seen many churches become financially stronger than ever, with stronger balance sheets and stable-to-growing giving, along with controlled expenses. All this begs a thought: your church might be in the best position today, financially, to refinance and secure a long-term fixed rate.

Thrivent Church Financing is in active discussions with multiple church leaders across the country that have recognized this risk and are considering this very decision, with some churches considering refinancing — potentially at a higher rate and even though a couple years ahead of its maturity — for the very reasons I've shared.

As the saying goes, "Only three things are certain — death, taxes and Christ's return." Although we don't know what the future looks like for interest rates, please don't shy away from investigating your options with an experienced church lender. CE