



# Church Mortgages

BY PHIL MYERS

**During the last** three and a half years, borrowers, including churches, have enjoyed an unprecedented availability of low-interest-rate mortgage money from an expanding spectrum of lenders. New entrants into the church-lending arena have included banks of local, regional and national scope, seeking new commercial relationships with churches and their congregations, and new lending relationships as their traditional commercial borrowers struggled. On the one hand, banks have had enormous capital available to them at low cost. But, until recently, they have had fewer business borrowers able or willing to borrow in the slow economy. This imbalance has contributed to an aggressive foray by banks into the church mortgage market, to the benefit of many congregations.

As the economy has picked up steam, and businesses have begun to grow again, business borrowing demand is increasing. It remains to be seen if this will prompt banks to redirect their lending efforts away from churches and back to their traditional commercial customer base. Many banks prefer lending on lines-of-credit basis as opposed to commercial (i.e., churches) mortgage lending since lines of credit allow them to constantly adjust interest rates charged to their customers, as opposed to fixing rates during periods of rapid rate changes.

Churches that are anticipating borrowing funds in the coming year will probably find banks a bit less aggressive in rates and lending policies than in recent years. What will be very apparent will be a hesitation by banks to lend at fixed

rates to church borrowers for any significant timeframe. From 1999 to 2000, the prime rate rose approximately 4 percent. From 2001 to 2003, the prime rate fell approximately 5 percent. It is this interest rate volatility that lenders don't like to lend on a long-term basis.

At present, it is inevitable that rates are going to rise significantly over the next two years. The 10-year Treasury Note, a benchmark used by mortgage lenders, and home mortgage rates have risen more than 100 basis points (1 percent) in the last quarter, confirming the market's perception of rates. Thus, if a church desires a short-term construction loan or an annual variable loan, banks will be accommodating since the banker can "hedge" against imminent rate increases by raising rates they charge the church on the loan. On the (Continued on page 28)

other hand, negotiating even intermediate term mortgage loans with balloon payments out five to 10 years will be a challenge, since lenders are well aware that rates are on the rise and don't wish to commit to "below market" loans.

Thus, the critical question churches preparing to borrow should address before approaching lenders is what duration of loan they need. Is the church leadership willing to accept a lower rate in the near term in exchange for inevitable rate increases in the years to come? Is the church willing to re-enter the mortgage market in three or five years when their loan balloons (is due in full) when rates may be higher, or lower? Or, does the church leadership prefer to lock in a long-term (15 to 25 years) fixed-rate loan that may be at a higher rate than short-term loans but which eliminates future interest-rate risk?

To answer this fundamental question, the church must consider whether it is a "budget-based" church. As the leadership projects out future budgetary objectives and restraints, can they reliably plan occupancy costs when the interest rate on their mortgage will change periodically? Does an incumbent Board of Trustees wish to "hand off" to the next board the responsibility of re-negotiating or refinancing their mortgage in several years? Or, is it important to the church's planning to know what each mortgage payment is going to be for the next 15 to 25 years?

How the church answers these questions will influence what type of lending institution they approach for the mortgage loan. It will also help them determine whether to use a construction loan, which, when construction is completed, must be converted to a permanent loan at the interest rates prevailing at the time. Alternatives to short-term and variable-term bank loans are widely available from the specialty denominational lenders and, for many independent churches, from specialty investment banking firms. These investment banking firms specialize in conducting bond underwritings for churches, thus using the capital markets rather than the depository markets for mortgage funds. These firms vary tremendously in size and distribution capacity, and it is important to research them before entering

into a lending agreement. Some of these firms are very good at selling bonds to the borrowing church's members. Some churches do not prefer this method since members may contribute less to their church if they purchase bonds, making the church's new debt-service obligation difficult. The larger church bond investment banking firms structure their financings much like is done on Wall Street for large corporations and have

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strong bond distribution channels through which to sell millions of dollars of bonds to public investors.

The key advantage to bond financing is that bonds provide fixed-rate, long-term rates to the borrowing church. Every payment to be made by the church over the next 15 to 25 years is known at closing, giving the church the ability to budget well into the future without interest-rate risk. This advantage is most critical at times such as the current period, when it is clear that rates will be rising significantly in the next several years from the

recent historical lows. Just as homebuyers flock to fixed-rate loans when rates show signs of rising, commercial and church borrowers have to anticipate the same market influences.

Another advantage is that bond financings do not typically carry significant "restrictive covenants" or loan terms often found in bank loans that require the borrowing church to maintain certain financial ratios or performance levels in future years or risk having their loan accelerated. Obviously, with bonds or a traditional bank loan, the borrowing church must make its mortgage payments or lose its worship facility on which the lender will hold a mortgage.

So, what's the downside of long-term bond financing vs. shorter-term bank financing? Bond underwriting is a highly specialized and complex process for which the church will pay the underwriter a fee, or "discount," from the gross bond issue amount. Underwriting fees will typically run from 4.5 percent to 8 percent of the total loan amount and are paid from the loan, not up-front by the church. A simplified way to analyze the impact of these fees is to divide the fee percentage by the number of years of the loan term. Add this decimal to the stated fixed rate of the bond issue to determine the average "cost of money" being charged. Using this, you can compare the bond financing to other lending options the church has.

Rarely in recent history has the imminence of interest-rate increases been more clearly telegraphed. This prompts a focused assessment by a church's leadership on whether its borrowing needs should be met with a shorter-term or longer-term loan. Once this fundamental question is answered, banks or specialty church lenders, such as bond underwriters, should be contacted for their best terms. Be prepared to work quickly, however, since delays in funding your loan at this time could result in higher rates than anticipated as interest rates begin to edge upward with the improving economy. **RPN**

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