5 Ways Churches Can Improve Their Chances for a Loan

Banks look for these best practices, ECCU leader says.

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As far as Randy Marsh is concerned, aerial skiing stands out more than any other event at the 2014 Winter Olympics. The speed, the agility, the flips, twists, and lands–they grab his attention unlike anything else he watches. And to stress the uniqueness of this sport, one of the event's medalists recently said that attaining the highest level of achievement requires training at the highest level of difficulty.

That mentality resonates with Marsh, ministry development officer for the Evangelical Christian Credit Union, who spoke Wednesday morning to about 150 executive pastors and senior pastors attending the 10th annual XP-Seminar in Dallas.

For churches that need capital to expand their ministry work, and navigate the flips and twists that come with that work, their best chances for success will only come from demonstrating their highest levels of financial management ability in good times and bad.

While the economy continues to mend from the Great Recession of five years ago, Marsh acknowledged the recovery has created a "new reality for banking and lending," placing increased scrutiny on churches looking to secure a loan for a building project or ministry initiative. (Sister publication *Christianity Today* recently reported the continued challenge of church foreclosures, although signs of improvement were also noted, including ECCU's decision in 2013 to end its two-year hiatus on new loans.)

Like aerial skiers, church leaders must demonstrate their performance under the highest level of difficulty in order to achieve more, Marsh said.

Based on ECCU's work with nearly 2,000 churches and ministries, Marsh presented five steps–couched in five questions–to improve a church's chances of qualifying for a loan (although churches of all types and sizes can review all five to improve general financial health, too, he added):

1. **Character: If the church can afford to, will it repay the debt?** This reveals whether good management is in place, Marsh said. Does a church make the hard decisions when times get tough? "Sometimes it's hard to be responsive," he said. "Some churches are better managers than others." Those that show they can take thoughtful steps in the midst of actual or anticipated challenges are ones more likely to make good on promises like loans, which strengthens their case with lenders.

2. **Cash reserves: How much is enough?** Unrestricted cash available to the church is vitally important for handling an unforeseen problem and banks want to see enough set aside for a response. For instance, should an unexpected dip in giving occur, "the cash reserve becomes critically important," Marsh said. For churches, the target is enough cash to cover 90 days of operating expenses, while schools should target 90 to 120 days, and parachurch organizations should target up to 180 days, he added.

   "Everyone wants the very best [interest] rate. One of the ways a church can do this is to show adequate liquidity," Marsh said.

3. **Cash flow: Can the church afford to repay the debt?** Part of the analysis here involves assessing a church's salary expense ratio. Marsh broke it down into three buckets:

   1. Debt (including a mortgage): When this nears 35 percent of a church's income, or exceeds it, it "becomes unhealthy for the church," he said.

   2. Staff expenses: The upper limit here is 35 percent–if a church's debt is already at 35 percent of income. Keep in mind, staff expenses for many churches typically run closer to 45 percent or 55 percent, but those churches likely have a lower percentage of income tied up with servicing debt.

   3. Ministry: Again, the upper limit here is about 30 percent, but only if the debt and staff expenses are at their upper limits of 35 percent each.

   With those buckets in mind, lenders can calculate a debt service coverage ratio (DSCR) to determine the church's cash available to service debt:

   Step 1: Adding net income, interest expenses, and depreciation/amortization;

   Step 2: Dividing what's available for debt by the annual debt payment amounts;

   Step 3: Dividing the result of Step 1 by the result of Step 2; which calculates ...

   Step 4: The DSCR, which lenders and regulators prefer to equal 120 percent or less (meaning the church, at most, has the ability to pay its debt, plus 20 percent of that debt on top of it).

4. **Collateral: If the church is willing but unable, how will the debt be repaid?** Right now, the maximum that lenders will finance is 75 percent loan-to-value, Marsh said. This means, for instance, that churches need to make down payments of 25 percent for property. For many young churches, "the hardest part is coming up with the down payments," Marsh said.

5. **Climate: What are the trends?** Is the church in a period of growth or decline? If a sustained decline is underway, "it's increasingly difficult to finance that church unless that church has a history of managing decline [well]," Marsh said.

In a closing Q&A with XP-Seminar founder David Fletcher, Marsh told the executive pastors and senior pastors that accurate financial statements and regular internal and external audits can go a long way toward demonstrating their church's character to a lender. Plurality of leadership within the church (in both the diversity of board membership and the structure of decision-making at the top levels), adherence to church bylaws, and clear contingency and succession plans also provide reassurances for banks.

And one final point that shows the church can make the flips and twists–and nail the landing, in aerial skiing parlance–is when the church's congregation votes to take on the debt. Such a vote reveals each member has acknowledged what's at stake and committed to do their part, Marsh added.

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