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Have Faith in Church Lending

If you believe in this niche, you may be rewarded with heavenly business

In today's commercial real estate market, recovery still seems like a distant promise. Although commercial real estate loan originations increased 36 percent in 2010 from '09, there is still $1.4 trillion in commercial real estate debt outstanding, according to figures from the Mortgage Bankers Association.

It is not all doom and gloom, however. Many experts believe that the commercial real estate market will recover in the next two years. In addition to increased loan originations, commercial mortgage-backed securities (CMBS) issuance also has increased. By the middle of this past May, $8.6 billion in CMBS had already been issued according to Bloomberg, and JPMorgan Chase & Co. predicted that total issuance this year could reach $45 billion, a significant increase from the $11.5 billion issued in 2010.

As the commercial mortgage market begins to ramp up, lenders may soon be taking a closer look at a property type that, in the past, they have been reluctant to approach: churches.

In fact, lending to churches and related affiliates may be the next growth opportunity. Commercial mortgage brokers who are knowledgeable about this niche can grow their business as more lenders delve into this profitable market segment.

Reluctant lenders

Historically, mortgage lenders have been reluctant to lend to churches for a number of reasons. First, for the most part, they don't understand the dynamics of church economics and operating systems. Second, there has been — and still is — a reluctance to foreclose on a church. Third, the majority of church growth is focused

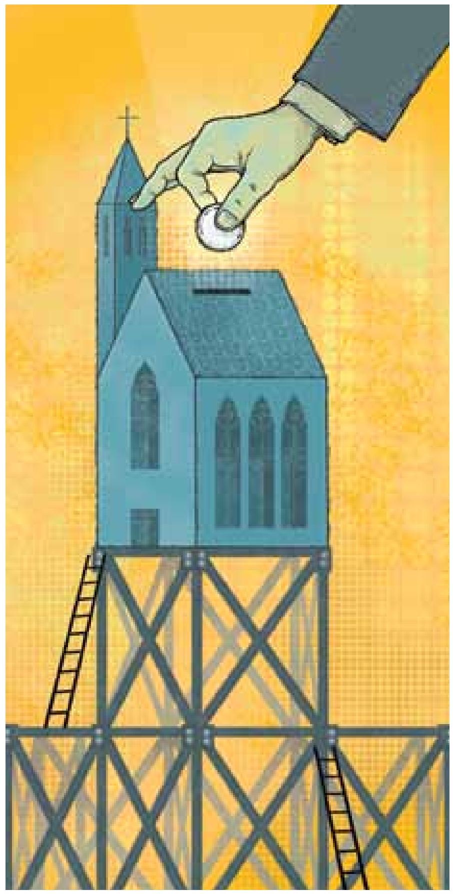

Illustration: Dennis Wunsch

on independent churches that do not have the same financial structure as large, organized denominations like Catholic, Presbyterian and Episcopalian churches — where most balance sheets and operating performances are codified and centralized at the top and in the aggregate.

Because of the variations in financial structures, lenders often struggle with the church operating model, especially in terms of how to evaluate its economics. This leads to the perception that churches are not good businesses. More important, they perceive that churches have no understanding of how lenders operate. Consequently, lenders often determine that churches are not finance-ready and are too high-risk. This, combined with a reluctance to foreclose, often causes mortgage lenders to pass on these funding opportunities.

Mortgage brokers can take advantage of this channel of opportunity by building more understanding of churches, their benefits and their model of operations.

Opportunities abound

Despite the fact that society has become more secular than in previous centuries, more than half of Americans still attend a place of worship. The church-at-large continues to have a vital impact on people and the communities in which they reside. From hospitals and universities that tend to the sick and help provide literacy to the masses, churches often provide assistance for everyone.

From a mortgage-lending perspective, there are hundreds, if not thousands, of churches that can be served. One key segment is the independent, nondenominational church movement that has become known as the megachurch movement. In

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the U.S., this movement began to take root and flourish in the early 1970s. Today, according to the Hartford Institute for Religion Research, a megachurch is defined as a church that has an average of 2,000 or more attendants weekly. The institute maintains a database of more than 1,300 megachurches in the U.S., and more than half of these large institutions are nondenominational or independent churches.

Generally, denominational megachurches have more in common with other megachurches than with smaller churches within their own denomination. Churches in this niche tend to fit the megachurch classification while remaining similar to other churches in the movement in terms of appearance, logo, worship style and vision. In addition, there also are thousands of smaller churches and emerging megachurches with lending potential.

Financial foundation

The average megachurch attendee is somewhat more educated than representative church attendees, according to a Hartford Institute report. More than 50 percent of megachurch participants have college degrees or higher. In addition, megachurch-attendee households are more affluent on average than overall churchgoers. Forty percent of megachurch attendees were at or below the 2000 U.S. median household income of $50,740 versus nearly 50 percent of all churchgoing households. In addition, 26 percent of megachurch-attending families had an income of $100,000 or more, although just 15 percent of all comparison churchgoers had a similar income level, according to the report.

Using an average annual donation per member of about $1,000, gross revenue per institution would be about $2 million per year. These churches' market revenue size could be as much as $135 billion annually.

In using mortgage-lending determinations for assessing a borrower's capacity, which is typically based on annual earnings available for debt service — or the equivalent of earnings before interest, taxes, depreciation and amortization (EBITDA) — this would be $34 billion for the megachurch niche. Assuming a debt-coverage ratio of 1.25, interest rate of 7 percent (mortgage constant of 8.5 percent) and a 25-year amortization, that level of EBITDA could support a lending opportunity or potential of more than $320 billion.

Formula for success

Beyond the capacity of churches as solid borrowers, a number of other formulas can be used to illustrate the opportunity available for mortgage brokers when so many other tried-and-true revenue channels have dried up in the economic downturn.

First, there are further economic considerations. Churches tend to be highly liquid, predictable cash cows. Revenues, for the most part, reflect ongoing donations from members. More important, they tend to be recession-proof. In difficult times, members tend to continue to give and, in many cases, actually give more.

Second, there must be a better understanding among the lending community of how church financing works. There seem to be two prevailing — and contrasting — positions currently. Churches are wary of lenders and credit, and on the other side, lenders tend to view churches as wanting heaven on earth in terms of financial terms and conditions.

Just as churches build bridges in the community, a bridge is needed to cross the divide between churches and mortgage lenders. There are professional organizations that can help to determine whether a church is finance-ready or if more must be done to develop the necessary operational expertise to satisfy guidelines for lending.

Getting finance-ready

Because mortgage brokers build their competitive advantage on relationships, it makes sense to look at churches as long-term partners. With these relationships, there must be faith, trust, communication and shared understanding and respect. Part of making the most of the opportunities within church lending is being able to help a church understand how to become finance-ready and how to be a creditworthy client.

An organization is considered finance-ready when it has invested enough time on constructing the building blocks of its organizational, operational and financial systems so that a lender wants that organization as a client. Mortgage brokers can play a role in helping a church understand the key organizational and financial requirements that it must deliver to illustrate its sustainability and viability in terms of fulfilling lending obligations.

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Although commercial mortgage brokers face an uncertain market and economy, a careful look at church lending, where the church is finance-ready or where a process is in place to get the organization finance-ready, could create significant opportunities. These growth partnerships are more than a leap of faith. For brokers, they may be a reliable, somewhat recession-proof revenue stream constructed on quantifiable track records of sustained profitability. •