Mortgages for churches and charities (January 2014)

A Joint Church Growth Trust and Church Mortgages Briefing Paper

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Table of contents

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1 Introduction

Buying property and/or raising a mortgage can be a lengthy process fraught with many pitfalls, so it is important to have an awareness of what some of these pitfalls may be. This document does not cover every aspect or go into great detail, but tries to raise awareness of some of the issues and considerations that arise to help churches and Christian charities through the process of raising a mortgage or purchasing property.

Probably the most important point to make is that proper planning and preparation are crucial. Trying to save money by doing everything themselves has often resulted in major difficulties for churches and charities. Expert advice is not free but it can end up saving considerable cost. Enlisting the help of advisers on mortgages, as well as building, planning and insurance and having a good accountant can be invaluable.

2 Vision

It is important to know why a church or charity wishes to purchase premises or land or to fund an extension or building project. The church leaders and/or charity trustees need to have a vision of their work and purpose, in order to know whether the property or alterations to the property will fulfil the vision. This is important for a number of reasons:

- Projects can take some time and commitment to bring to fruition and without a clear vision and "realistic" goals prospective lenders may be unlikely to want to lend.
- "If you don't know where you are going you will never get there".
- Projects need clear and firm leadership.
- Lenders want to see commitment from the church leadership and membership to the project.

Many lenders are not interested in lending money for monuments and will want to know how the property will be utilised, how it will be of benefit to the community, whether it will be used for charitable purposes and whether there will be a commercial element or an opportunity to generate income.

Most lenders will require sight of a business plan before they will consider lending. A church may already have a plan or a vision statement that can be used or adapted for this purpose.

The business plan usually will need to cover the past, present and future. A little bit of history to show how the church or charity has arrived at the present place preferably showing leadership and growth, a statement of the current make up and workings of the church or charity and looking forward with the vision and future plans of the church or charity. It is important that this is not just wishes and dreams but a carefully considered realistic plan for the next few years. Whether or not a business plan is submitted this is absolutely essential. As one lender stated "too many applicants think that the necessary resources will fall out of the heavenlies just because they are Christians, but that does not wash, even for Christian lenders"! The business plan should be produced carefully as it is one of the most important documents in an application. Stewardship have produced a free guide to making a business plan (see the link in the appendix. Church Growth Trust or Church Mortgages can also give help and advice and work with churches and charities to ensure that it is a robust plan.

With smaller applications some lenders will not require a business plan, but may ask many more questions at a detailed level. Being able to answer these completely and accurately in the first instance gives the lender confidence in the borrower. In contrast applicants that give broad-brush answers or avoid answering questions will limit the lenders confidence in the borrower and may demonstrate a lack of a full grasp of the issues.

3 Security

A mortgage is a loan that is secured against land or property so that in the event that the borrower defaults on their loan repayments the lender can then recover their monies by repossessing the property and selling it on. No lender will lend if they think that this is likely to happen, as they do not want to be seen as the ones evicting a church or a charity and will generally discuss ways of avoiding this if the church's or charity's circumstances change. However they do need to have the security of the property as a last resort. Therefore it is important to look at a property or land from a lender's perspective. A lender will consider a number of matters, including:

- The value of the property. Most lenders will lend up to 70%-75% of the value of a property but this could be as low as 50% or as high as 80%. The lower the loan to value the lower the risk to the lender and potentially the better the loan terms.
- How suitable the property is for its intended purposes.
- The property's size, location, accessibility and car parking provision, as well as local public transport and proximity to residential dwellings.
- Whether the property has the correct planning consents or whether they could be obtained easily.
- How attractive the property would be to other prospective buyers. There are a limited number of churches that could be buyers, so lenders will look at alternative uses. Whether the property could easily be used/sold for commercial premises. What the demand is likely to be in the locality for church or community use buildings.
- Whether there are any covenants or restrictions affecting the property.
- The condition of the property and whether there are any essential works or repairs to carry out.
- Whether the property meets the necessary standards or regulations (e.g. fire regulations and disabled access).
- Sometimes a lender may wish to take additional security so if the church owns other properties the lender may want to take a legal charge on one or more of these. The lender may also even seek personal guarantees or additional security from the trustees.

4 Affordability

One of the key decisions for a lender is to decide whether they think that the borrower can afford to repay the loan, both at outset and ongoing. Note that it is the lender who decides and not the borrower.

To ascertain whether the borrower can afford to repay the loan the lender will want to see:

- Historic accounts for the church/charity, usually for the last two to three years. A lender will look at accounts to see that there is sufficient surplus or retained income to maintain loan repayments (and often with a buffer of up to 50% too). The lender will strip out any costs that will not be ongoing, such as rental payments if moving from rented to owned premises, but will add in additional costs such as maintenance and insurance.

- Bank statements for the church/charity for three to six months to see that the account has been well managed. Sometimes as conditions of the loan lenders will require that you move your day to day banking to them so that they can monitor ongoing affordability.

- Projections and cashflow forecasts for the next 3 – 5 years. They may require submission of management accounts at regular intervals to see that budgets are managed and adhered to.

5 Terms

5.1 Length of Loan

Most commercial loans are over terms of around 10 – 15 years, although this can sometimes be as low as five years or sometimes as long as 20 years or more. Repayments are higher for shorter terms. The length of the loan can be affected by the ages of the key people (leaders/trustees), as lenders will need to consider the higher risk if key people retire or even die. This needs to be considered at the outset.

5.2 Variable and Fixed Rates

Many loans are arranged on variable rates, usually at a fixed margin over the Bank of England Base Rate (BBR), although often with a minimum pay rate (i.e. if the minimum pay rate is 5%, even if the variable rate was 3% above a BBR of 1%, the actual variable interest rate payable would be 5%). It is sometimes possible to secure fixed rate loans if preferred, but only for short periods such as five to seven years.

5.3 Interest Only

Sometimes a period of "Interest Only" payments can be agreed of up to 12 months to ease the burden when there are many other costs in the first year.

5.4 Early Redemption

Often lenders will impose "Early Redemption Penalties" whereby they will penalise the borrower if they pay off the loan agreement within the first few years. It is always good to think about future plans and check these clauses before committing to a loan agreement.

5.5 Other Terms

Some lenders will have ongoing criteria regarding the financial position of the borrower that has to be met, documented and submitted to the lender periodically.

There will be a requirement for the property against which the loan is secured to be insured with the lenders interest noted and often key individuals may need life insurance.

It is best to try to establish and negotiate these terms early on in the process if possible.

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6 Finding a lender

For most churches or charities their first option is to speak with their existing bankers to see if they would also lend to them as they should be aware of the financial circumstances of the church/charity. However in practice many of the high street banks are either unwilling to lend or will only want to lend at high rates or at a low “Loan to Value (i.e. the value of the property/security is a lot higher than the value of the loan) ratio.

The good news is that there are other lenders including some specialist Christian lenders and some charity lenders who will not only look at the commercial viability but also the social or charitable benefit. One would assume that the best place for a church to obtain a mortgage is from a “christian lender”. Although it is true that they should have more understanding of a church’s needs and if they are “non profit making” they should be able to offer competitive rates, this is not always the case and it is well worth exploring all options.

Trustees should explore all options to fulfil their duties. In section 10 of the Charity Commission’s guidance document CC33 Acquiring Land it states “If trustees are buying land with the aid of a loan, it is their duty to secure the best borrowing terms reasonably obtainable by comparing interest rates and other terms between various lenders.” In practice this will be very difficult for most trustees to do without enlisting the help of a specialist broker, who can approach different lenders on behalf of the applicant to negotiate and secure the best rate and terms possible.

7 Costs

There are various costs that need to be considered by a church/charity, including:

7.1 Deposit

Typically lenders require 25%–30% of the purchase price to be paid by the church/charity as a deposit. This can sometimes be as low as 20% and, depending on the lender and the project, it could be 40% or even 50%. If a lender is being asked to take a risk and lend they will want to see the borrower commit by “putting their money where their mouth is”. Also the higher the “Loan to Value”, the higher the risk to the lender and therefore the harder it will be to secure a loan and the terms and rate are likely to be higher.

Generally speaking lenders will not want the borrower to be borrowing funds elsewhere for the property so they may want confirmation that “gifts” from church members and other sources are indeed gifts and there is no obligation to repay them.

7.2 Valuation

The church/charity may already have a valuation of a property, but a lender will want a valuation to be carried out by someone approved by them and according to their terms of reference, as there are many ways that a property can be valued. Commercial valuation fees are significantly higher than residential fees, so before spending money on a valuation or survey it is best to check that it will be acceptable to a potential lender.

7.3 Arrangement fee/Commitment fee

Lenders will usually charge an arrangement fee of around 1.5% to 2% of the loan amount; although it is sometimes possible to negotiate a slightly lower fee if presenting a strong case.

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Often lenders will charge the fee on acceptance of their loan offer. However they may require a proportion of it or even a separate fee earlier in the process to show your commitment.

7.4 Broker fee

If the services of a broker are used to obtain a mortgage at the most competitive rates they will need to be paid. This can be agreed at the outset as an hourly rate, a flat fee or a percentage of the loan amount. Some lenders will pay the broker out of the arrangement fee so the borrower does not have to pay additional fees. The broker should explain and agree all fees at the earliest possible opportunity.

7.5 Solicitors fees

Although some lenders will allow dual instructions (i.e. using the same solicitor for the bank and the church/charity), this is much less common with commercial loans than with residential, so it is most likely that the church/charity will need to cover their own solicitors' costs and also those of the lender's solicitors. The lender's solicitors' fees could be significantly higher so it is always best to get a quotation first.

7.6 Planning fees

There may be planning fees to pay for change of use or for any building work or alterations that are required, as well as Building Regulation fees.

7.7 Building/refurbishment costs

Lenders will want to see that sufficient provisions have been made for alterations, refurbishments, furnishings and for meeting fire, health and safety and hygiene regulations.

It is also worth bearing in mind that costs are likely to increase, as there may be a delay between designing and starting the project. It may therefore be prudent to allow for a 10-20% increase.

Please also remember that the costs of erecting community type buildings are almost always more than the finished value of the property. Any loan will be based on the value of the completed property, so allowance needs to be made for this. For example if a new building costs £1m to build, but is only worth £800,000 once completed and the lender will only offer a loan based on 50% of final value, the church/charity will have to raise £600,000, rather than £500,000.

7.8 Professional fees

The services of architects, building and quantity surveyors, structural engineers, mechanical and electrical designers, building inspectors, planning consultants or health and safety advisers. Their costs should not be underestimated as they can add significantly to the project costs (e.g. 15-20%).

7.9 Stamp Duty Land Tax

Often charities are exempt from Stamp Duty Land Tax, but it is always best to check first.

7.10 Insurances

See the section on insurance.

8 Funding

Raising the funds for a property purchase or refurbishment project is nearly always one of the most challenging tasks and is one of the key reasons why it is best to plan and prepare well in advance. In addition to the mortgage the church/charity will need to raise significant funds and will need to give thought to how they can raise these additional funds.

Borrowing the money (from another lender or members of the church) is rarely a good idea as this has to be repaid and a prospective lender will factor this into their decision making process. Firstly they will not be happy that the borrower could not find enough of their own funds and secondly the repayments of the loan would have to be taken into account for affordability; even interest free loans from church members will probably be frowned upon.

Giving is one of the main sources of funds which could come in the form of tithes, offerings and written personal pledges where individuals promise to give a certain amount either as a one off gift or a regular amount. Please note that pledges should only be made if they are affordable and will be fulfilled. Lenders may only take into account a proportion of any pledges, due to the risks attached.

There are many ways of fundraising and church members or charity supporters will probably think up all kinds of ways to raise funds. Be careful to weigh up each suggestion for the time, energy and cost involved against the potential funds raised. Pick out the most productive and less crazy ideas. Often asking for people to give sacrificially will yield amazing results and it is important to have as much of the church "on board" with the vision as possible, so that they have ownership of the project as well.
Another source of funds well worth exploring is grants which may be available from many different sources for various projects. Time spent in research and some carefully completed application forms for well thought through projects can yield significant funds. Grant funders normally have strict criteria governing what they will and will not fund. Applicants should not ignore these criteria. If they do, they will waste their time preparing the application and will simply annoy the funders and possibly prejudice the success of future applications. Please be careful though of conditions or "strings" that may be attached to funding from some sources.

Church Growth Trust will soon be producing a briefing paper on this subject so do look out for this.

9 Insurance

There are a number of risks that every church should consider insuring against and some that are compulsory. The list grows when property and a lender are added into the equation. Here are some of them:

9.1 Public Liability and Property Owner's Liability

This offers protection against claims for injury etc. by anyone visiting premises.

9.2 Employers Liability

This is legally required by any organisation that employs people, including volunteers.

9.3 Buildings Insurance

The full reinstatement cost of building will be required by the lender with their interest noted on the policy.

9.4 Contents Insurance

This offers protection against theft, fire, flood and in some case accidental damage.

9.5 Key-person Insurance

Life or long term injury cover for key leaders/trustees/staff may be required by the lender.

9.6 Other Insurance Cover

In addition to the above churches/charities should consider All Risks Cover, Trustees Indemnity Insurance, Event insurance and Motor Insurance, which is legally required for any vehicles. The Charity Commission's guidance "Charities and Insurance" is recommended. It is advisable to speak to an Insurance Broker with experience in this area for advice and arranging policies.

10 Mortgage Report

Under Section 124 of the Charities Act 2011 there is a requirement for a charity to obtain an order from the Court or the Charity Commission agreeing to the mortgage, unless the "charity trustees have, before executing (agreeing to commence) the mortgage, obtained and considered proper advice, given to them in writing, on the relevant matters". "Proper advice" is the advice of a person who the trustees reasonably believe has sufficient ability in and practical experience of financial matters to give them sound advice. This person may be a mortgage broker (not arranging the mortgage) or the church/charity's accountants, but can be an officer or employee of the charity. However they must not have any financial interest in the loan, which the charity is taking out. The person needs to provide advice in writing on three matters:

- whether the loan is necessary in order for the trustees to be able to pursue the particular course of action in connection with which the loan is sought;
- whether the terms of the loan are reasonable, given the status of the charity and
- the ability of the charity to repay on those terms agreed with the lender.

11 Preparation

It is important to plan ahead and seek advice early. Time should be given to develop the vision and communicate it with the church so that there is unity and commitment. The church/charity need to has the right structures and leadership in place. The correct documentation also needs to be prepared and accounts and returns submitted and filed with the relevant bodies in a timely manner.

Establish who will be borrowing the money and what liabilities (if any) will the trustees incur. This will be determined by how the charity is set up. With a Trust the individual trustees would be signing a loan agreement and would be ultimately liable for the repayment of the loan. Trustees (or directors) of a charitable company or a Charitable Incorporated Organisation (CIO) would have limited liability, as the company or CIO is signing the loan agreement. Trustees under a Trust will need to bear in mind that they would need to be removed from the mortgage/charge when they retire as trustees; otherwise they will still be responsible for the mortgage.

Whether the trustees have the necessary powers to borrow funds should be checked in the charity's governing documents.

12 Documentation

Different lenders will require different documents, but as a general rule most lenders will or may require (depending on the size of the loan) the following documentation at various stages in the process:

- Governing Documents – Constitution, Trust Deed, or Certificate of Incorporation and Memorandum & Articles of Association.
- Last three years accounts.
- The last three-six months bank statements.
- Management accounts for the current year, ideally including the budget and actual figures.
- Cashflow Forecasts for the next three to five years.
- Business Plan.
- CV or details of experience of key people (trustees or leaders)
- Evidence of Deposit, including tithes, offerings, building fund, grants and pledges.
- Property details, including sales particulars, title documents, planning, architects and other professional reports.
- Planning permissions and Building Regulation consents.
- Valuation Reports
- Mortgage Report

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13 Contact Details and Further Information:

Charities Act 2011 Section 124:
http://www.legislation.gov.uk/ukpga/2011/25/section/124/enacted

Charity Commission Guidance on Acquiring Land:
http://www.charitycommission.gov.uk/media/94067/cc33text.pdf

Charity Commission Guidance on Sales, leases, transfers and mortgages – What trustees need to know about disposing of charity land:
http://www.charitycommission.gov.uk/media/94019/cc28text.pdf

Charity Commission Guidance on Charities and Insurance:
http://www.charitycommission.gov.uk/media/94227/cc49text.pdf

Stewardship's paper Lending a Hand:
http://www.stewardship.org.uk/documents/MortgagearticleShare6.pdf

For general advice on property, mortgages and insurance:

Giles Arnold of Church Growth Trust is a Chartered Surveyor and able to advise on many property related issues.

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Simon Shefford of Church Mortgages/Northants Mortgages is a regulated broker who can help to source and arrange very competitive mortgages and insurance.

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