Financing Your Vision:

Temporary & Permanent Financing Options for Nonprofit Organizations

Publication Created by CIL.
We love to share, so feel free to reproduce with credit!

Let's Chat: www.cil.org | info@cil.org

Table of Contents

Financing Your Vision:

Temporary & Permanent Financing Options for Nonprofit Organizations

INTRO

The following is a summary and comparison of various major categories of temporary and permanent financing options related specifically to development of non-profit projects. This summary is intended only as a high-level overview and there are multiple variations possible with each option, as well as hybrid options, which could also include conventional financing models typically available to for-profit entities.

TMI?

Too much information? We understand this stuff is complicated and we welcome the chance to sit together and guide you through it. Reach out at anytime: info@cil.org.

Temporary Financing Options

Whether funds are directly raised through donations or from various borrowing options based on the constructed value of the project and operations, the expenses for the project will very likely be incurred prior to receiving the funds. If this is the case, some form of temporary financing will be required. This may be referred to as a construction loan (normally when the take-out funding is some type of permanent financing) or a bridge loan (normally when the take-out funding is a reimbursement or event-specific funding source that can be used as an additional guarantee in the underwriting process).

1. Donor/Foundation Direct Participation

Organizations could seek direct participation by a donor or charitable foundation which would provide the construction/bridge funding required for the project. In this case, the loan might be low-interest, or even interest-free. This is a particularly attractive option if the donor/foundation is also going to be involved in the permanent financing, as they would at least partially take themselves out during the conversion, the underwriting process might be easier, and the timeframe might be shorter.

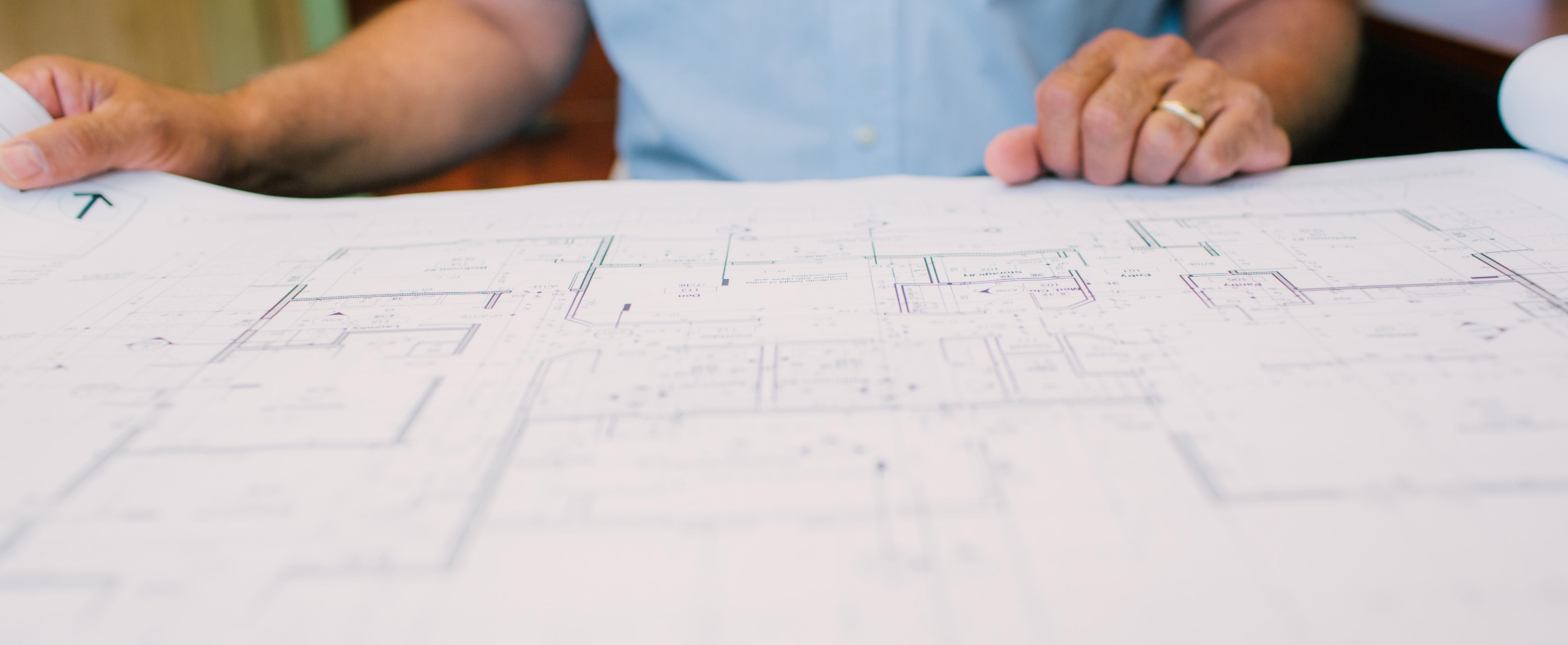
Sometimes this method can be used when foundations are precluded from making donations during construction, but want to participate in the permanent financing. Structuring the temporary financing as a loan may allow them to participate, as it would not be a donation.

The potential downside to this method includes the possibility of a more difficult (less predictable) process, if this is not a normal course of business for the funder, and potential limitations on the amount or timing of the funding, based on the size of the funder.

What's Temporary Financing?

Temporary financing is often necessary to pay the costs of the project before your permanent financing makes its way to your accounts payable.

Publication Created by CIL
We love to share, so feel free to reproduce with credit!



2. Traditional Construction/Bridge Loan with a Bank or Financial Institution

Organizations could apply for one, or more, conventional construction/bridge loan(s). The rate can vary based on the risk level, guarantee, and underwriting process. This could take quite a while to get in place, unless relationships already exist with potential lenders. The process of conversion from temporary to permanent financing can be difficult, or complicated, based on the timing, prerequisites, and guarantee/release requirements.

3. CIL's Existing Construction Line of Credit

CIL has a $55 million construction line of credit through a bank group led by TD Bank. The terms, repayment methods, guarantee requirements, and rates are already set, so these funds could be used quickly if CIL is the owner of the proposed project. The line of credit requires a first position mortgage of the project and has limitations concerning the use and type of projects which may be financed. This option works best if the permanent financing option was through a CIL bond, as described on page nine. It would be possible to create an agreement that would allow this temporary funding with other permanent funding options but it would require consideration of the transfer of the ownership and the complexities in the conversion of the temporary to permanent financing, as a result.

Construction Loan versus Bridge Loan

Construction loan is normally when the take-out funding is some type of permanent financing. A bridge loan is normally when the take-out funding is a reimbursement or event-specific funding source that can be used as an additional guarantee in the underwriting process.

Permanent Financing Options

Large projects could use a combination of permanent financing options. Nonprofit organizations can make use of tax-exempt conduit bonds to help fund capital projects. Only government agencies can issue bonds. However, it is possible to have a government agency act as the conduit issuer and have the obligation for repayment rest solely with a nonprofit agency as the conduit borrower. In these cases, the government is not obligated to repay the debt. Potential conduit agency participation can vary based on the type of project, ultimate use, and location.

Tax-exempt bonds are bought and sold in an informal market referred to as the municipal bond market, or tax-exempt bond market. Although it is an "informal" market, as there is no formal exchange (e.g., New York Stock Exchange), it is a highly regulated market subject to securities, laws, and regulations. The cost of issuance of bonds is largely independent of the bond amount and normally ranges from $300,000 to $500,000. Therefore, larger bonds often have a lower relative cost of capital than smaller bonds.

There are a variety of ways to structure a conduit bond. In general, they can be structured as a Variable Rate Demand Bond (VRDB) or as a Direct Placement/Purchase Bond (either at a fixed, or variable rate), which are sometimes referred to as "Bank Direct Purchases" (BDPs).

It is also possible to purchase a "swap" which temporarily fixes the rate of a VRDB, or a "rate cap" which acts like an insurance policy against rates exceeding a defined limit for a period of time. Furthermore, VRDBs are normally "credit enhanced" by using a letter of credit, typically from an AAA-rated financial institution, unless the borrower has its own rating. CIL and most small to medium sized nonprofits would likely be classified as junk-bonds and would require a letter of credit enhancement in order to obtain an acceptable rate in the open market.

VRDBs, with a letter of credit enhancement, are remarketed on a weekly basis and therefore require the participation of a remarketing agent. Normally, they also require the establishment of a “trustee” to collect and distribute payments. The number of entities involved, and the fees charged by each one, must be considered in the calculation of the cost of capital, in addition to the actual rate of the bond (which, as mentioned, is reset weekly).

Although the VRDB can be established for the full bond duration (typically 20, 25, or 30 years), the letters of credit are often issued annually, or at most, for a period of two to four years. This means that in addition to the variable rate of the bond, the borrower faces uncertainty as to the long term cost of the letter of credit enhancement, which can be a significant portion of the cost of capital, typically being in the range of 1.75% to 2.5%.

The total cost of capital for a VRDB includes the potentially volatile weekly-reset interest rates, letter of credit fees, remarketing fees, trustee fees, rating agency fees, and potentially fees associated with swaps or caps. All costs must be considered and weighed in the evaluation of funding options to ensure the chosen method is the best match for the organization’s needs and goals.

BDPs, on the other hand, are negotiated directly with a bank and the term is normally a maximum of 10 years. The advantages of BDPs include not requiring a remarketing agent and the ability to fix the rate for the term of the BDP.

The bond term would normally exceed the BDP term and a second, third, or even more BDPs might be required in the future. Normally, the same bank will offer to issue subsequent BDPs related to a bond, but there is no requirement for them to do so, or for the borrower to stay with that financial institution, if they can find a better deal elsewhere.

BDPs are a newer financing instrument but the majority of tax-exempt bonds are now using this option, as many banks can’t meet the stringent requirements for the VRDB letters of credit. Also, reforms, referred to as Basel III, resulting from the financial crisis of 2008, have reclassified how banks must account for letters of credit and have eliminated many of the advantages previously enjoyed by this method.

The total cost of capital for BDPs and VRDBs are often quite similar at the time of issue, but can vary significantly over the life of the bond. In general, the cost of issuance is lower for BDPs than VRDBs, owing largely to less parties being involved and usually a simpler structure overall. For the same reasons, closings can be quicker for BDPs than VRDBs, once all approvals are obtained. Both VRDBs and BDPs should be considered by organizations considering bond issues

What’s That Acronym?

In real estate, we are pretty fond of acronyms. Here’s the translation:

VRDB = Variable Rate Demand Bond

BDPs = Bank Direct Purchases

Permanent Financing Options, Cont.

Although a combination of options might be an appropriate approach, for clarity, the following options for consideration are presented, as if they were used independently:

1. Fundraising/Donations

The main advantage of this approach would be having little, or no long term debt resulting from the project. However, this comes at the "cost" of greater risk during operations, since the funds would be invested directly in the facilities. It also misses an opportunity to establish an endowment fund that might help the long term mission of the organization. There might also be disadvantages associated with restrictions on use, timing of funds availability, and complicated conversion process (from temporary to permanent), based on various potentially contradictory requirements. In most cases, the best option is likely to combine fundraising, grants, State/Town aid, and some type of bond financing for the "gap".

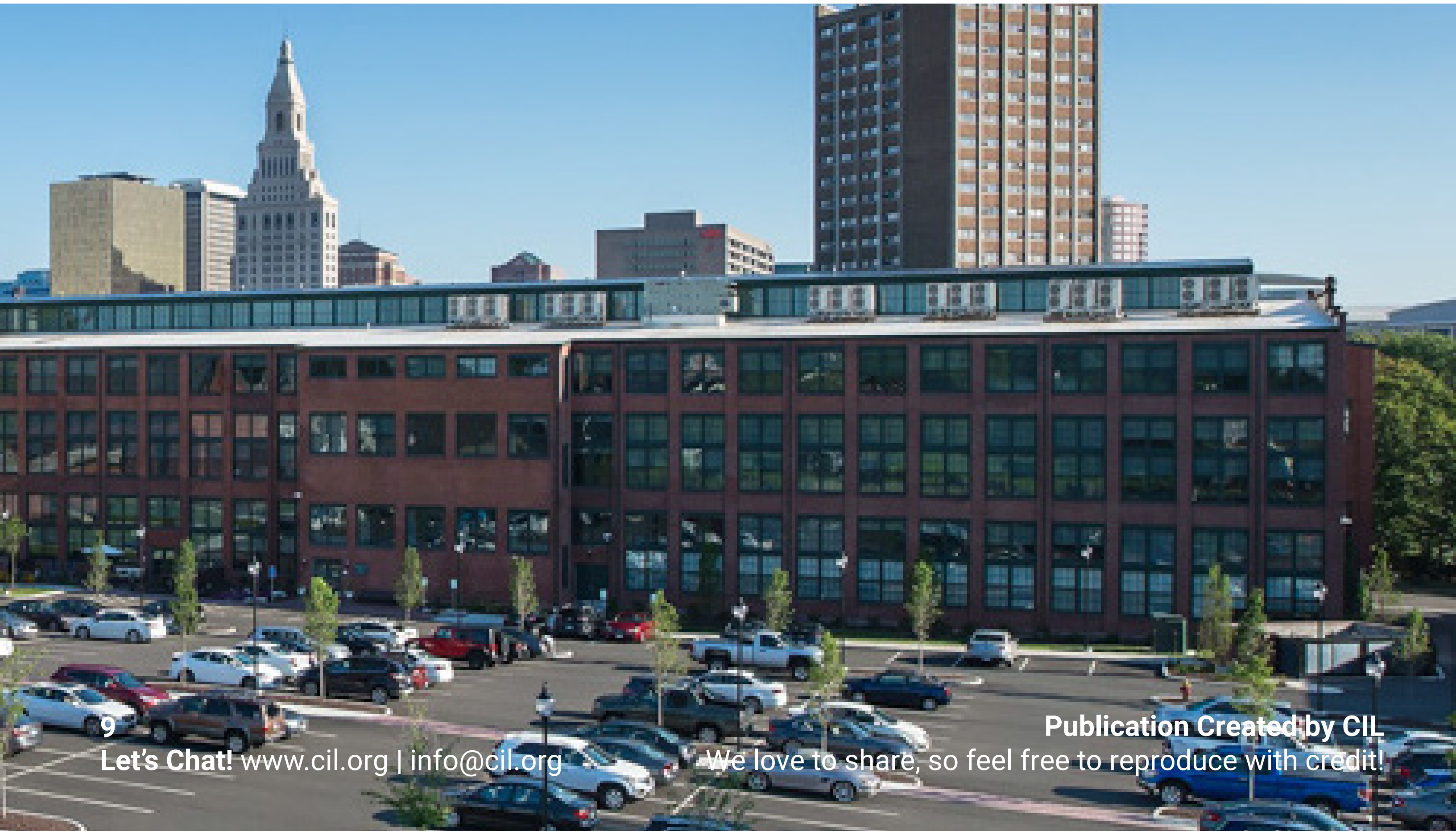
2. Tax-Exempt Conduit Bond with the Organization as the Borrower

CIL could provide advice and assist the organization through the process of securing a tax-exempt conduit bond, including helping to identify potential banks (for a letter of credit or BDP), and coordination with the conduit agency, etc. For organizations with an endowment or other resources, some, or even all, of the bond amount could be guaranteed by the endowment fund, and the rates and terms for a BDP might be very favorable.

Presuming the endowment fund could grow at a faster rate than the BDP, there would potentially be money left over after the bond is retired. This could be even more significant if additional funds were obtained for the endowment, or if some of the BDP cost could be carried through future operational surpluses. BDPs often include prepayment penalties, but this could be negotiated, if the organization wanted the option of early payment. This wouldn't be an issue with a VRDB. In general, tax exempt conduit bonds allow for more flexible, long term funding, by leveraging the borrowing potential related to fundraising activities.

3. Tax-Exempt Conduit Bond with CIL as the Borrower

As with the use of CIL's existing construction line of credit, this option would require CIL to have title to the project. CIL would then lease the project to the organization. Often we are able to include a donation clause in the lease which donates the property to the leasing organization when the bond is retired. We can establish a fixed lease amount, or flexible terms, based on the project and the needs of the organization. Normally, half of any excess revenue (the result of the lease amount collected less the bond payment due, based on actual rates) are placed into a segregated account, which acts as a hedge against future rate increases and potentially can be used to pay the bond off early. The main advantage of this option is our familiarity with the process and the agencies that would be involved. The other major advantage for smaller projects is that we can often combine them with other projects in a single bond issue – thus reducing the cost of capital by spreading the issuance costs over multiple projects. Generally, we prefer to size bond issues as $20 million, or more, for VRDBs or $10 million, or more, for BDPs. Below these limits, the issuance costs result in relatively high costs of capital.



Publication Created by CIL
We love to share, so feel free to reproduce with credit!

Let's Chat: www.cil.org | info@cil.org