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Nonprofits using loans, tax-exempt bonds to fund needed capital projects

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Fund-raising auctions, capital campaigns, annual giving funds — they are among the tools a nonprofit organization uses to finance its good works. But they may not be enough to get the job done, especially if that job is a costly capital project with a time line in place and the clock ticking.

For that reason, nonprofits are taking on debt — and making it work for them — to create sustainable capital projects, said Miriam Sevy, president of Seattle-based Leora Consulting Group LLC.

“Making projects the old-fashioned way — it doesn’t work ... anymore,” the longtime financial adviser and former investment banker said during a Washington State Housing Finance Commission conference held earlier this year in Everett.

For more information on tax-exempt bond financing, contact the Washington State Housing Finance Commission by calling 800-767-4663, sending e-mail to askuscp@wshfc.org or going online to <http://www.wshfc.org/>.

The “old-fashioned way” — with a group planning the new facility, raising funds through donations, buying land, paying for construction and finally moving in — doesn’t provide the flexibility an organization may need in today’s environment of ever-rising real-estate costs, Sevy said.

“Sometimes it makes sense to borrow money because you need to move fast,” she said, noting that the land an organization needs may be off the market by the time a capital campaign is successfully completed.

Other times, it makes sense to borrow money because an organization needs to have financial momentum over the long term, such as when a capital project involves a number of phases and there is no guaranty that donors for one phase will be donors for another phase, Sevy said.

And then there are those projects that just do not lend themselves to capital campaigns, she said, noting that repairing pipes or making electrical upgrades to a facility, while necessary, lacks the urgency that drives people to pledge money.

No matter the circumstance, the trick is to make debt a forethought, not an afterthought, when planning for the project at hand and selecting a lending vehicle that is right for the job, Sevy said.

“When I first started, people would say capital campaigns and debt do not mix. Not true, but timing is key — not too early or too late,” she said.

In the case of a capital campaign, knowing how much an organization can borrow from a lender can better help it evaluate how much needs to be raised while enabling the nonprofit to buy the land and pay for construction before costs rise.

Then, funds raised through the capital campaign, whether they came in as lump-sum amounts or trickled in as multi-year contributions, can be put toward paying off the capital project, Sevy said.

As for the lending vehicle, nonprofit organizations can turn to a special financing tool designed specifically for large capital projects: the tax-exempt bond, which enables investors lending to a tax-exempt borrower to pay no tax on the interest. The end result: lower interest rates for the nonprofit.

The lower interest rate is a benefit in the long run, but the tax-exempt bond can come with higher up-front fees, simply because of the paperwork involved, Sevy said, listing the “major players” involved in the process, including:

- The nonprofit borrower.
- The Washington State Housing Finance Commission, which is the conduit issuer.
- The bank or insurance company, which is the guarantor.
- The underwriter to market the bonds.
- The financial adviser, who reviews pricing and structure.
- Lawyers for the borrower, the bond, the guarantor and the underwriter.

For capital projects of less than \$3 million, nonprofits can turn to a less costly tool known as streamlined tax-exempt placement, or STEP, which uses standardized documents to cut costs.

According to the Washington State Housing Finance Commission, savings to the borrower are about 1 to 2 percentage points below the market rate with STEP financing, and interest rates are lower still for larger projects using the traditional tax-exempt bond financing.

Local nonprofit organizations that have taken advantage of the tax-exempt financing programs over the years include the Boys & Girls Clubs of Snohomish County, Little Red School House Inc.

and the YMCA of Snohomish County, according to the housing commission.

Whether a nonprofit group decides to create a sustainable capital project with a conventional loan or with one of the housing commission's tax-exempt bond tools — and it is critical that the board is on board with this decision — selecting just the right lender is key to the process, Sevy said.

“You need to find out who in the financial institution specializes in lending to nonprofit organizations. ... All banks are not created equal in fees, charges and interest rates,” she said. “... Put at least as much effort into selecting a guarantor as you do your contractor.”