https://forum.savingplaces.org/viewdocument/expanding-the-pie-capitalizing-rev

Expanding The Pie: Capitalizing Revolving Fund Loans for Historic Preservation Programs

Preservation Leadership Forum

To pursue their missions of historic preservation, local nonprofits engage in many charitable activities--including education, advocacy, and development. Education informs the public about the benefits of maintaining historically and culturally significant properties. Advocacy encourages the preservation of threatened sites and opposes the thoughtless demolition or "modernization" of significant buildings. Development--the buying, restoring, owning, selling, marketing, managing, and renting of real estate--effectively and directly preserves historic properties.

This tool has expanded the capacity of local preservation programs, allowing direct intervention and control through ownership. Development, however, requires significantly larger financial resources than education and advocacy--and challenges the local organization to find new and sizable sources of financial support. Relying on traditional charitable "gifts" or grants is frequently insufficient and misses the opportunity to create and use revolving loan funds to finance more and larger projects. Using "credit" or debt--money that is borrowed and/or loaned out--can expand productivity and help an organization achieve its mission.

Having capital under management also gives the local historic preservation organization additional power to influence other players in the development field. If your organization is still hesitant to recruit debt, remember that credit is the economic lifeblood of every community. Without access to credit, neighborhoods cannot be built or improved, businesses cannot be started or expanded, homes cannot be built or sold, houses cannot be maintained or repaired, and few of us could afford a college education. Credit, responsibly managed, is a valuable tool that feeds the local economy and provides both individuals and organizations the opportunity to improve personal and economic situations. Without the use of credit, there is no growth, less economic development, and little progress.

CHOICES FOR REVOLVING LOAN FUNDS

Typically, a local preservation group will secure special purpose grants and use those gifts for acquiring or restoring properties. The purchase of the real estate consumes the granted funds and, unless and until the property is sold to another

party, the capital is unavailable for reuse. That same local preservation group could instead procure special purpose grant funds and lend those funds to others engaged in the acquisition and restoration of properties. As a lender of capital, the organization will receive its capital back on a specified schedule for reuse--and have earlier access to some of that capital. As the lender, the preservation organization has significant influence over the management of the property and can even offer incentives to achieve its mission. The group will quickly learn that providing financing affords almost as much influence on the development process as doing the development directly.

Imagine, now, how much larger the revolving loan fund would be if it were being supplied with debt capital--funds borrowed from other sources to finance the development of historically significant real estate. The local preservation organization is no longer limited to grant sources for its capital--sources that are rare, operate under limited budgets, and have significant competition for their grants. Expanding the list of financial sources to include lenders--of all types--greatly expands the quantity of capital available and, in turn, the volume of development that can be influenced. Some historic preservation organizations, such as statewide networks or other larger institutions, are able to serve as financial intermediaries in support of their member organizations--borrowing from multiple sources, managing a pool of debt and equity capital, and making loans to multiple projects within their markets. Borrowing capital for historic preservation allows a local historic preservation organization to:

- control and protect a greater number of properties;
- respond more quickly to threats and opportunities;
- keep projects more affordable, expanding options for property use;
- greatly leverage limited grant resources; and
- even out cash flow.

In summary, local preservation organizations should explore the options afforded by including debt capital (or borrowed funds) in their financial tool boxes. They can lend directly from their grant capital pools; they can borrow capital for their own development efforts; they can borrow capital and then lend it to others. In all cases, revolving loan funds greatly increase their influence and support of historic preservation by creating a pool of creative, user-friendly, affordable and patient financing for pre-development, construction, acquisition, and mortgages.

SOURCES OF DEBT CAPITAL

The paragraphs below describe how to borrow capital but do not describe how to lend that capital effectively. Local historic preservation organizations should gain a thorough understanding of lending policies and procedures, loan monitoring and servicing, and portfolio and risk management techniques before embarking on a lending program.

Foundations

We are familiar with the traditional grant-making role of private foundations. When these institutions make loans, they are called program-related investments (PRIs). PRIs are "investments" that, like their grants, support the overall mission of the foundation. The most valuable support from a foundation, of course, is a grant--an outright gift that need not be repaid. Foundations, however, can provide larger dollar amounts of support when the money will someday be repaid. Private foundations frequently favor programs that benefit low-income persons (so your chances of success are improved if your program serves a low-income neighborhood or prevents displacement of its residents).

Defining your historic preservation project in broader terms--such as community improvement or rehabilitation--may also enhance its appeal to foundations beyond those already in your corner. PRIs can be for long terms (up to 10 years, for example) and may be offered at very low interest rates (1-3 percent annually). Loan amounts can reach a million dollars, depending upon your organization's projects and organizational capacity. The IRS considers program-related investments to be in the nature of a "grant" made by the foundation--meaning that, upon its return, the foundation is obligated to re-commit those funds to meet its annual distribution requirements. Therefore, even though it is structured as a loan and has a periodic interest payment due, the foundation has an incentive to renew the loan.

Many larger or national foundations provide PRIs--but most smaller or local foundations are still unfamiliar with their potential lending role. Because the best strategy is typically to build your reputation close to home before seeking national support, your organization should be prepared to "educate" your local funders about PRI possibilities. This is an investment worth making. As more and more foundations learn about the benefits of lending some of their capital, PRIs will become more common from these smaller institutions. Community foundations--whose capital base and program focus are the local community--are the category of foundations most in tune with PRIs. Fortunately, they are also exactly the kind of funder who is most likely to be financially supportive of your historic preservation efforts and to lead the way by demonstrating to other smaller or local foundations new methods of providing support.

Banks & Thrifts

Financial institutions--banks and thrifts--can provide charitable organizations, including historic preservation groups, with equity capital, operating grants, or debt capital. Just as with foundations, grant support is the most beneficial contribution a bank can give--and this should always be asked for first. This creates the opportunity to invite the bank into an expanded relationship that eventually includes loans.

Banks typically want to charge closer to market rate (2 points over prime, for example) than any other providers of charitable debt capital. Although your organization should expect to pay slightly more for bank money, be prepared to

negotiate for a subsidized rate. Depending upon your project or the neighborhood in which your organization works, a bank may be willing to lend at prime or below--because of the other benefits that will accrue to it for such an investment. Banks typically commit loan capital for terms ranging from 3 to 5 years in amounts ranging from $25,000 to several hundred thousand dollars.

Be careful not to accept an early loan commitment from one bank that is either very small, very short-term, or includes a high interest rate because subsequent bank participants will want to follow suit. A loan to a local "community development" project can help a bank meet its CRA (Community Reinvestment Act) obligations--particularly in low-income neighborhoods. In addition, banks hope that your lending will create new borrowers and business opportunities for them in the future. So, the loan from the bank should be seen not as a "gift" but as an investment that makes business sense from a financial institution perspective.

Start your discussion with the bank where your historic preservation organization keeps its deposit accounts. This institution should be the most motivated to provide assistance that will increase your cash flow, your time deposits, and your level of business with it. Then move on to other banks in your community--any bank or thrift whose CRA market includes your historic preservation district. If your bank is not inclined to lend to you, consider moving your account. Make inquiries to determine which persons involved with your local organization have relationships with which banks. These individuals may serve on boards or committees with bankers, may be grantees of the bank, or may hold personal or business accounts with the bank--and they can introduce you to the right person.

If your network has few relationships, simply start with the larger banks--and work your way toward smaller competitors who will likely want to "keep up with the Joneses." A precedent relationship with one respected bank will enhance your ability to secure the participation of others. Be prepared to talk like a banker--to discuss lending procedures, management of loan losses, collateral and security requirements, and how the organization plans to manage its portfolio. When discussing loan possibilities, you should emphasize that the loan will be an asset on the bank's books and not just another charitable contribution. You are asking to do business with the bank--business that will bring it a modest short-term return but eventually more business and an improved community over the long term.

Religious Institutions

Sacred texts from all major faiths affirm the responsible use of one's "gifts" and connect faith, money and justice. The ideals of self-help and shared blessings, therefore, appeal to committed persons of all faiths. Religious institutions--such as religious orders of women, denominational judicatories, and local congregations--have been among the most active and supportive providers of debt capital for community development efforts, especially those that serve or benefit low-income persons. Religious orders typically lend $5,000 to $50,000 while denominations (regional judicatories) can commit amounts from $50,000 to $200,000.

Religious institutions tend to invest for shorter terms than banks and foundations, but for longer terms than individuals. With experience, they will frequently extend their loans or renew them for longer terms after they are comfortable with your track record. Religious organizations also fall in the middle range on interest rates--a denominational endowment will seek closer to market return while a community of sisters will accept a lower rate, even though their retirement income depends upon it.

There is no best denomination for seeking capital (they differ by region of the country), but Roman Catholic women's orders are one of the best places to start--especially those which have sisters in service in your region and most especially if your use of the loan capital will be targeted to assisting low-income families and/or other disenfranchised persons. You may be proposing to use the loans to subsidize facade renovations and property acquisition in an African-American commercial strip. You may be providing low-cost home improvement loans in an historically significant immigrant neighborhood. You may be renovating an old hotel that is currently an SRO (single-room occupancy) building serving indigent or otherwise homeless men. All of these appeal to lenders with religious affiliation. Religious organizations also provide a ready source of individuals willing to put their money where their faith is, and be financially supportive of local projects. Through these religious institutions, local charitable organizations also find and build relationships with business people, for example, who in turn introduce the charity to bank presidents, corporations, and other civic organizations.

Individuals

Individuals represent the largest (and largely untapped) source of debt capital. And local historic preservation organizations almost always seem to have strong, committed, and financially capable networks of individual supporters who are knowledgeable about their mission and are ready to help. Individuals can be most flexible in providing low-cost loans--and will frequently lend to community development efforts at 0 percent interest. Individuals, however, tend to commit funds for shorter terms--a year may be the longest a person can tie up a portion of his/her savings. But, just as with religious organizations, experience brings familiarity which brings comfort which brings renewals for longer terms.

While most individuals will lend smaller amounts of money ($1,000 to $10,000), don't be surprised if you come across that retiree with a large mutual fund willing to make a $100,000 loan. Start with the folks you know--your local members, your local volunteers, your local contributors, and even your staff. Remember, however, that in many states securities regulations prescribe how your request to individuals can be made, by whom and to whom. This attempt to prevent unscrupulous characters from foisting non-existent investment opportunities off on innocent consumers also defines the methods you may use in soliciting capital.

Individuals contribute (either gifts or loans) because someone asks them--so go ahead and ask. Some of the more effective individual recruitment techniques

include small house parties and project tours. In these efforts, a group of prospective lenders can learn together what the preservation organization is doing with its revolving loan fund, and why loans are needed. They can discuss their concerns with each other, ask questions as a group or as individuals, and feel privileged to be part of a special group. Follow up these group presentations with individual contact. Call or visit each participant and answer their additional questions. Suggest an amount, a term, and an interest rate. Some individuals who can afford to lend for long periods of time might also be willing to contribute the principal at maturity.

Tips for Success Develop a strategy with regard to seeking grants versus loans. You don’t want to accidentally convert a grant into a loan. Instead, use the loan option as a means of getting participation where you wouldn’t otherwise get it or expanding existing participation many fold. Make certain up front that those you approach understand your request is to "borrow" funds. They are used to being asked for gifts but, in this case, you are going to use the money in a way that brings in revenue that can be used to repay it. Sell the benefit that will accrue to projects to be financed, not the organization. Those who may be capable of lending you capital are interested in what difference it will make--in development terms--not just that you want or need more capital. Emphasize productivity--the value of time, the benefit of being able to act quickly, to be flexible and therefore achieve results--both when considering the use of credit and when marketing to prospective "investors."

Publication Date: Fall 1997

Author(s): Vicki Gillette
Volume:12
Issue:1