Loan Financing for Montana Nonprofit Organizations: A Primer

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Montana Mission Investing Group

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The Montana Mission Investing Group (MMIG) is made up of representatives from nonprofit organizations, foundations, state agencies, the financial industry and interested individuals. This network shares information about mission investing within the Montana foundation community as well as with nonprofits that have endowments and those looking for financing, the financial services industry and individual investors. Mission investing is often referred to as: impact investing, socially responsible investing, double/triple bottom line investing, or green investing, and encourages investment in Main Street as well as Wall Street.

The MMIG also explores ways to create Montana-suitable approaches to make mission investing straightforward and easy. MMIG hosts monthly conference calls, and has co-sponsored webinar and panel presentations on loan financing and mission investing with the Montana Nonprofit Association, and hosted learning sessions in Bozeman, Helena and Missoula.

Loan Financing for Montana Nonprofit Organizations: A Primer was created to provide basic information for nonprofit organizations interested in exploring the use of loan financing to help them build their capacities as they work to carry out their missions. Additional resources are included for those who wish to learn more about loan financing and mission investing.

For more information about MMIG, contact Bill Pratt at bpratt9@msn.com. On a limited basis, MMIG members may be able to meet with staff and board members of Montana nonprofits to address your specific situations.

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Introduction: This primer answers several common questions about Loan Financing for Nonprofit Organizations. This is presented as a series of short questions and answers, starting with loan characteristics, through advantages/benefits of loans, to preparing for successful loans**.**

1. **What Is A Loan?** A loan is the act of giving money, property or other material goods to another party in exchange for future repayment of the principal amount along with interest or other finance charges. A loan may be for a specific, one-time amount or can be available as an open-ended line of credit up to a specified limit or ceiling amount.

   The terms of a loan are agreed to by each party in the transaction before any money or property changes hands. If the lender requires collateral, that is outlined in the loan documents. Most loans also have provisions regarding the maximum amount of interest, as well as other covenants such as the length of time before repayment is required. For More Information: http://www.investopedia.com/terms/l/loan.asp#ixzz4pNPGTnVY

2. **Why Loan Financing?** Nonprofit organizations are well acquainted with the traditional sources of revenue – grants and contracts, contributions from individuals, businesses and organizations, earned income and investment income from cash reserves and endowments. *As an additional revenue source, loan financing, has the potential to help your organization address financial challenges* including:
   - variability in cash flow,
   - "bridge financing" to initiate programs prior to the receipt of grant, contract, pledge, or other revenue,
   - accelerating the purchase of equipment or facility renovation and construction,
   - expanding the scope of projects
   - directing fundraising to other projects,
   - kickstarting new initiatives, and
   - providing up-front financing while capital campaigns take place.

   According to national sources, loan financing is increasingly being used, in partnership with commercial lenders, foundations, individuals, and organizations, to provide the capital needed to build organizational capacity, and meet identified needs.

3. **What Are Some Montana Examples?** Nonprofit organizations throughout Montana have used loans to help them carry out their missions. Some examples include:
   - Creative Arts Center (Eureka) - a mortgage to finance the purchase of its facility.
   - Big Sky Film Institute (Missoula) - a loan to purchase a condo in the Wilma Theater. BSFI used the space for four years and then sold the space and paid off the loan.
   - Community Leadership and Development, Inc. (Billings) - a commercial loan is part of the financing package to help this organization build multi-unit housing on Billings' South Side.
   - Disability Rights Montana (Helena) - a bond was issued to help DRM purchase its headquarters building.
   - Exploration Works (Helena) -a five-year loan to pay off aged accounts payable.

- Holter Museum of Art (Helena) - a loan to remodel the former Montana Powder store into a visual arts facility, and another loan to repair its roof.
- Homeword (Missoula) - loans and bonds to create affordable housing in the organization's service area.
- Missoula Children's Theatre (Missoula) - a loan to complete its capital improvements.
- Neighbor Works Montana (Great Falls) - loans from individuals and foundations to provide affordable housing for low-and moderate-income families.
- NOVA Center for the Performing Arts (Billings) - a loan to purchase its building.

4. **How Can A Loan Help My Organization?** Most of us are very familiar with personal loans to finance higher education, real estate, and auto purchases. Businesses often use loans to purchase inventory and meet cash flow needs in anticipation of seasonal sales. However, nonprofits tend to be much less familiar with using loans. In fact, many are reluctant to take on debt. Some may see the need to take out a loan as representing fundraising failure by the staff or board, or believe, depending upon the size of the project, that the organizations must have all the funds in hand before making significant program or capital expenditures. It is true that loan financing entails risk and requires additional executive and financial staff involvement, as well as careful board oversight. However, with the appropriate planning and care, it can provide essential and timely revenue.

   The uses of loan financing by nonprofits varies. Much of the experience of Montana nonprofit organizations is for the purchase, repair, renovation and construction of facilities. Unlike the traditional approach to funding facility development where typically all or most of the funds needed are raised before the project begins, <u>financing may enable an organization to accelerate the start and completion of a project</u>. In additional to capital projects, other uses include obtaining a line of credit to help an organization weather short-term fluctuations in cash flow, bridge financing to help manage delays in cash flow where grant or contract payments (or other revenues) are anticipated at a future date, and capital to enable an organization to invest in its own growth by kickstarting a new venture.

5. **Is It Only About The Money?** In addition to providing revenue, loan financing can:
   - expand an organization's relationships with existing funders and key resource people to enable it to get ready for financing,
   - identify new individual and institutional funders,
   - strengthen and build the board and its expertise,
   - enhance organizational capacity, skills and knowledge,
   - help change the understanding and the paradigm about how nonprofits are supported, and
   - enhance an organization's leadership position in a community.

6. **What Are The Benefits Of Loan Financing?**
   - Loans can be faster to arrange than grants.
   - Loans are not competitive and must primarily meet the lender's criteria.
   - Loans may be less restricted to a funder's focus or requirements. The application will be judged on the basis of the business plan demonstrating an ability to manage and repay the loan while achieving what the organization wants to do.
   - Loans often involve less reporting and monitoring.

- Loan payments are made in advance, on meeting agreed milestones, not installments from funders to reimburse expenditures.

7. **How Do I Ensure That My Organization Is Ready For Financing?**
   - **You need a strong track record of accomplishment and funding** in your community or service area, in order to instill confidence in a lender or funder.
   - **You need a strong board** that is skilled and engaged and is willing to explore new ways of funding your organization to carry out its mission, and being innovative in how it accomplishes this. Your organization will have to present its need for capital in detail to a lender, and identify how much you want to borrow and for how long.
   - **Your governing documents must not prohibit the organization from borrowing** and potentially pledging assets as security. Consult an attorney regarding your legal authority. It is also <u>helpful to have policies and procedures in place to help guide the board and staff, such as regarding what kind of financing is allowed and what level of risk the organization is willing to take on and the steps needed to manage those risks.</u> NOTE: Typically, the lender will want a board resolution approving the debt.
   - **Your organization should be able to demonstrate good financial management and record keeping**, as well as skills and systems to manage the loan and repayment. To see how your organization measures up, please review the Principles and Practices section on the Montana Nonprofit Association's website (www.mtnonprofit.org/PPNEabout/), which deals with financial management, as well other nonprofit finance resources listed in the Appendix of this Primer.
   - **<u>You must have a successful track record of verifiable and predictable income that shows that you can successfully pay back the loan in the time required</u>**. This is a conservative approach and every organization varies in its comfort to take various levels of risk.

8. **What If Your Organization Is <u>Not</u> Ready To Seek Financing?** This is an opportunity to build organizational capacity in those areas that need improvement using your own resources, or by seeking grant support. Your organization may want to improve its financial management systems, fundraising or earned income activity, and board recruitment for skills pertinent to loan financing. In addition, you may wish to seek outside consultant services to help you do this. A searchable database of Montana consultants is available on the website of the Big Sky Institute for the Advancement of Nonprofits at www.bigskyinstitute.org/janda/consultants.php?PageID=118

9. **How Does My Organization Prepare To Seek Financing?**

   - **Identify key resource people** in your community to help you develop the project, better understand and find financing options that may be available to your organization, and the costs involved. This might be, for example, a commercial loan officer, staff at a local Community Development Financial Institution, or a SCORE volunteer Naturally, continue to build your knowledge about the basic issues involved in financing.

- **Consider establishing an advisory committee** made up of board, staff, and advisors with special expertise in financing, real estate, and contracting, which are relevant to the size of the project.
- **Identify financing options** that best meet your needs, including the costs involved and processes needed to receive financing. As with your other fund raising activities, build on your existing relationships to help you expand funding opportunities.
- **Make periodic progress reports** to your board and relevant committees about the various funding and financing options, as project plans develop.
- **Refine your understanding of the need for** financing so that you can make the case to funders. That can be as simple as preparing a basic request for a short-term loan to meet cash flow needs or a complex project that requires creation of a complete business plan… the funders may, in fact, require it. It is very helpful if your organization is familiar with pulling together a variety of funding sources to support a particular program or project. Crafting the different elements of a loan package is a similar process. The plan should explain or provide:
    - how the project will help your organization carry out its mission, and the anticipated outcomes,
    - your capital and revenue sources,
    - your oversight and management needs,
    - a cash flow estimate,
    - staffing and contracting requirements and responsibilities,
    - a project timeline, and
    - how you will repay the loan and related costs.

  As with your personal financing, **shop around for the best deal** regarding interest rates, length of the loan, and loan fees. Reduced interest rates may enable your organization to seek a larger loan, OR it can help you reduce the cost of a loan. Getting co-signers or organizations to guarantee a loan may help you get a loan and reduce the interest rate.

10. How Does My Organization Find Loan Financing? Build on relationships that you have or can develop to identify financing possibilities. Here is a list of strategies and sources of loan financing:

A. Look within your own organization.

- Can you borrow from existing cash reserves, if they are sufficient enough to enable you to also meet unforeseen emergencies? Before doing so, adopt policies to require rebuilding of these reserves, and specifying the interest rate you will pay to offset what you would have earned during the period of the loan. For More Information: Operating Reserves for Nonprofits from the National Council of Nonprofits.
- You may want to have quiet conversations with your board members and major donors, who would be open to an investment opportunity that has both a financial and social/cultural return, thus investing in Main Street as well as Wall Street. In fact, if your interest rates are competitive, e.g., compared to Certificates of Deposit, they might loan you more than they contribute annually. This provides an opportunity to

engage donors beyond your usual request for a contribution and expand their financial involvement.

B. Soliciting from individuals and organizations in your community.
(1) **Individuals**. In Montana, if you are soliciting loans from individuals for an organizational project, e.g., facility development or other organizational need, you will not need to apply for any outside approval. . However, it is recommended that your organizations has a loan policy and that your also create a formal loan agreement to use with all individuals or organizations making a loan to your nonprofit.

However, if you want to publically solicit loans from individuals for your organization in order to create or enhance a loan pool, e.g., to make loans for affordable housing, you will need to file for a nonprofit exemption from the Office of the Montana State Auditor, Commissioner of Securities and Insurance. See: MCA 30-10-104(1) and/or (8). As well you will need to create a circular or prospectus that provides potential lenders with information about your organization and its financing needs, the minimum loan amount, the interest rate to be paid and payment schedule, as well as any risk factors. It is highly recommended that you involve an attorney in this process to help ensure that your circular includes everything an investor would need to know about making this investment.

(2) **Nonprofit organizations.** Investment of endowed funds held by churches and other nonprofit organizations is regulated by the Uniform Prudent Management of Institutional Funds Act (MCA 72-30-101 to 212). These organizations, as part of their investment policies, may also address how their investments can respond to community investment opportunities, which provide both a financial return as well as social and/or environmental benefits. For organizations considering making loans, ensure that your bylaws allow your organization to do so.

(3) Commercial banks, especially those with whom you already do business, may be willing to provide a line of credit or make a loan for a particular project, especially if it can help them meet their Community Reinvestment Act responsibilities. They may not want to provide all the financing for a project, but can be an important part of the entire loan package of various loan sources, or "stack," especially if there are other lenders to help share the risk, Be sure to ask for consideration regarding the interest payment, fees and loan period because of your nonprofit status and service to the community, especially if you are serving a low-income, underserved, tribal or rural population, and clarify any restrictions regarding accelerated payment of principal.

(4) Local credit unions, which exist in many communities, may be another option to explore. They usually provide banking services and loans for cars and homes but may be willing to entertain your proposal. Typically with a credit union there is a membership requirement that can be met by opening an account.

(5) Community Development Financial Institutions. CDFIs are private financial institutions that are 100% dedicated to delivering responsible, affordable lending to help low-income, low-wealth, and other disadvantaged people and communities join the economic mainstream. By financing community businesses—including small businesses, microenterprises, nonprofit organizations, commercial real estate, and affordable housing—CDFIs spark job growth and retention in hard-to serve markets across the nation.

CDFIs are profitable but not profit-maximizing. They put community first, not the shareholder. CDFIs also provide technical assistance to help you with financing. For example, the Montana & Idaho Community Development Corporation (Montana & Idaho CDC), a CDFI headquartered in Missoula serving Montana and Idaho, makes loans to nonprofits across both states that range in size from $1000 to $20,000,000. Overall, Montana & Idaho CDC has provided over $400 million of financing for nonprofits and businesses across Montana and Idaho to over 600 organizations through its business lending and New Markets Tax Credit financing programs.

(6) State agencies with loan programs for community projects and facilities are another source if you can meet their funding priorities and eligibility criteria, e.g., Department of Environmental Quality's Alternative Energy Loan Program. NOTE: Using loans to reduce your energy "footprint" is a good way to proactively build your sustainability by reducing life cycle operational costs, create revenue to help pay for the costs of a loan, and show your community, as well as funders, that you are a responsible energy user.

(7) State or Municipal Bonds. In some cases, the State of Montana or local municipalities can issue Tax-Exempt Bonds for 501(c)(3) Charitable Organizations. These can be used for a variety of eligible projects such as health or human service facilities, affordable housing, and educational or cultural facilities. For More Information: IRS Publication 4077. Tax-Exempt Bonds for 501(c)(3) Charitable Organizations.

C. **Private Foundations** are increasingly becoming involved in making loans as well as grants, usually, but not exclusively, to their grantees. This is often called Mission or Impact Investing and can be done in two ways:

(1). **Program-Related Investments (PRIs) are below-market rate investments** that are made primarily to advance a foundation's charitable purposes and to meet foundation program objectives. Defined by the IRS tax code, they are eligible to count against a foundation's required 5% annual payout and often take the form of no- or low-interest loans to grantees, allowing a foundation to recycle repaid loans into new loans or other qualified investments.

(2). **Mission-Related Investments (MRI) are market-rate investments** that support a foundation's mission through generating positive social impacts aligned with the foundation's mission. Often referred to as: impact investing, socially responsible investing, double/triple bottom line investing, or green investing, these investments must meet applicable prudent investor standards just like conventional investments. These mission investments exist across all asset classes such as cash, fixed income, public equity, private equity, venture capital, and real estate.

Success in obtaining Mission Investments necessitates that organizations expand their relationships with existing donors and grantmaking organizations to encompass solicitation of loan funds of a variety of types. According to national sources, private foundations may respond to a request for a loan from one of its grantees or an organization that dovetails with its local focus, by making a PRI or an MRI. If they have never considered a loan before, you can raise this opportunity with them. Mission investing is an emerging field nationally and but nascent in Montana. We are all learning together about the topic and the experiences of individual nonprofits, communities and funders.

D. **Community foundations in Montana** are also becoming more aware of Mission Investing and making loans in the communities that they serve. There are numerous advantages for local community foundations to become involved in PRI-like or Mission-Related Investing in order to make their investments more aligned with their mission and providing additional capital for community development. As we look towards the future, it would make sense to develop a relationship with your local community foundation if you don't already have one. For more information about local community foundations in Montana, go to the web site of the Montana Community Foundation at www.mtcf.org.

E. Financial and wealth advisors in your community, with whom you have or can develop a relationship, may be willing to alert sympathetic High Net Worth Individuals to your organization's needs. For example, investments can be made from non-retirement assets or though assets held in self-directed Individual Retirement Accounts.

11. What If We Can't Make Our Loan Payments? Stuff happens. If, after you get a loan, you find that you will have problems making payments, immediately alert the lender(s) and meet with them to create a "workout," which is a mutual agreement to renegotiate terms on a loan to avoid foreclosure or liquidation. The renegotiated terms will generally provide some measure of relief to the borrower in terms of reducing the debt-servicing burden through accommodative measures provided by the lender, such as extending the term of the loan, rescheduling repayments, reducing the interest rate, and so on.

12. What Are Next Steps? A range of steps will help prepare your organization for a smoother and more successful loan process.

- Use the following resources, as well as key resource people in your community, to educate yourself and your finance and development committees about loan financing options.

- With your full board, discuss your readiness for financing, and how it might be used by your organization to improve your current situation or allow your organization to explore new horizons, as well as how it may impact other financial aspects of your organizations.

- Get legal advice to help you make any governance changes needed, especially if you plan to solicit private investments from individuals.

- Build your capacity and revenue streams, if necessary.

- Begin conversations with key informants in your community and your current funders about any experience, knowledge or plans they have about loan financing.

- If your organization is new to loan financing, obtaining and paying back a smaller loan (such as a line of credit) may be a way to reduce the risk, build your knowledge, and help you prepare to explore obtaining a larger loan.

- Structure your loan to best meet your needs. Staging the various elements of your loan “stack” to ensure that you have the appropriate level of funds at the time that you need them will help reduce unneeded interest expenses.

Appendices.

a. Loan Financing Checklist

- □ Do your initial homework to learn about the process, sources, benefits and risks of loan financing.
- □ Determine what expertise is needed by your nonprofit to help lead and manage these new responsibilities, and decide which are the preferred options for your organization, e.g., board recruitment, advisory committee, consultant services and/or knowledgeable volunteers.
- □ Discuss how loan financing might be used by your organization to build capacity, carry out mission, engage your donors, and attract new supporters.
- □ Work with your finance and development committees to calculate the loan amount that you can afford and how you will pay back the loan, interest charges and any fees. Be sure to build in a cushion in your calculations to help you address any unexpected costs.
- □ Make any governance changes necessary to enable your organization to receive loan financing. If you plan to solicit individuals in Montana, apply for nonprofit exemption from the Office of the Montana State Auditor, Commissioner of Securities and Insurance, and create a circular or prospectus to give to prospective investors.
- □ Identify local and state agency options for loan financing and explore opportunities for Program Related Investments from foundations from which you receive grants.
- □ Shop around to obtain the best deals for interest rates, fees and loan requirements, and put together the loan “stack” that best meets your organization’s needs and timing.
- □ Complete and submit the paperwork necessary to apply for loans from the variety of sources you have selected.
- □ Make sure that you accounting system will enable you to track and make loan payments.
- □ When loan financing has been received, move your project forward as expeditiously as possible to maximize use of loan funds.

- □ Make loan payments and reporting on time. If your organization has problems with repaying the loan, contact the loan source immediately to agree upon a "work around" to prevent default.

b. Publications and Websites.

Nonprofit Finance

- Brief Guide to Loan Finance for Trustees - www.trusteenet.org.uk/files/NCVO-Guide_to_Loan_Finance.pdf
- Financial Scan, Nonprofit Finance Fund - http://nonprofitfinancefund.org/financial-scan
- Funding Sources for Charities and Nonprofit Organizations - http://knowhownonprofit.org/leadership/governance/getting-started-in-governance/raisingmoney
- A Glossary of Loan Terms - www.gdrc.org/icm/loan-glossary.html
- Nonprofit Financial Ratios, Nonprofits Assistance Fund - https://nonprofitsassistancefund.org/sites/default/files/publications/nonprofit_financial_ratios_2013.pdf
- Principles and Practices: Financial Management, Montana Nonprofit Association - www.mtnonprofit.org/PPNE_Financial/
- When to Draw the Line: A Guide to Use and Abuse of Credit - www.nynp.biz/index.php/strengthening-nonprofits/10109-when-to-draw-the-line-a-guide-to-use-and-abuse-of-credit

Mission Investing

- A Call for Mission-Based Investing by America's Private Foundations by Rick Cohen - http://community-wealth.org/sites/clone.community-wealth.org/files/downloads/paper-cohen.pdf
- Community Foundation Portal: Your Road to Mission – Investing - www.missioninvestors.org/tools/community-foundation-portal-your-road-to-mission-investing
- Community Foundation Field Guide to Impact Investing - www.missioninvestors.org/system/files/tools/FieldGuide_102113_PRINT_v3.pdf
- Essentials of Impact Investing: A Guide for Small, Staffed Foundations - www.missioninvestors.org/essentials-doc (this resource includes essential information about Program Related Investments)
- A Short Guide for Impact Investing- The Case Foundation - http://casefoundation.org/resource/short-guide-impact-investing/

To learn more about mission investing generally, go to the website of Mission Investors Exchange (MIE) [www.missioninvestors.org] and sign up for its e-newsletter. MIE is where philanthropic innovators share ideas, tools and experiences to increase the impact of their capital. It is a national membership organization of foundations and mission investing organizations.