The Secret to Financing Your Capital Project

Save time and money with this low-cost financing option.

By Joseph P. Carlucci & Robert C. Schneider

There's a financing alternative available to nonprofits in most areas of the country that could reduce new-project financing costs by hundreds of thousands of dollars. For many nonprofits, however, it's an unintentional but well-kept secret. It is unknown or ignored by a surprising number of organizations preparing to finance capital projects. For those who know about it, however, the savings are huge.

• **The Masters School** in Dobbs Ferry, New York, was able to cut the cost of financing a new $17.6 million science building by some $600,000 a year. The building was financed with a bond issue that carried an interest rate of 3.4% to 3.5% over the initial 10 years of a 30-year bond. A bank loan would have been around 5% to 5.5%.

• **The Seamen's Society**, seeking a new facility to better serve abused and neglected children, purchased and renovated a commercial building near the Ferry Terminal on Staten Island with the proceeds from a $5.4 million low-interest bond.

> Traditional capital campaign fundraising efforts rarely catch up with the cost creep.

• **An assisted-housing project** in Vigo County, Indiana, was made possible with a $7.5 million, tax-exempt, variable-rate bond at an initial interest rate of under 2.0%.

• **The Professional Children's School** in New York was able to complete a 14,000 sq. ft. addition with funds raised through an $8 million variable-rate bond. The bond carried an initial interest rate of between 1% and 2%.

• **The Boys and Girls Club** of Greenwich, Connecticut, expanded its facilities and service to the community with the aid of $14.8 million variable-rate bonds with an opening interest rate of 1.2%.

What Is the Secret?

In each of the above cases, the financing "secret" was the use of low-cost, often tax-exempt bonds issued by state, county, or city economic or industrial development agencies. Such bonds are issued by authorities or agencies created by state statute. The specifics vary a bit from state to state. Depending on the state, the entities issuing the bonds may be called industrial development agencies, economic development authorities, educational facilities authorities, or something similar. Although state statutes may vary, IRS provisions exempting certain bonds from income tax are uniformly applied throughout the country.

The economic or industrial development agencies provide incentives and financing assistance, including bonds, on behalf of borrowers planning capital projects. More than 1,000 such agencies exist across the nation. In New

York State, for example, there are more than 150 agencies at the county, city, town, and village level. In other states, such as Connecticut, the agencies operate statewide.

One Example of the Benefits

Just how valuable tax-free bonds can be to nonprofits and the community — beyond the financing itself — may be seen in the experience of the Jacob Burns Film Center. Several years ago, a group interested in establishing a cultural art center purchased the shuttered Rome Theater in Pleasantville, New York. It had been closed as a theater for 33 years and was being used as office space. The group's objective was to create a cultural center devoted to the art of film. The center would include a state-of-the-art theater that would present the best of independent, documentary, and world cinema. The cost of renovations was projected to be in the millions.

With their mission and renovation plans drawn up, the founding board prepared to launch a $5 million capital campaign. Then they learned that they could use a tax-exempt bond as interim financing. It would enable them to finish the facility and begin operations within a year or two, far faster than they could raise the needed funds through a capital campaign. Completing the renovations would, in addition, enhance the fundraising campaign's success and allow the Film Center to quickly start generating operating revenues.

The board agreed to apply to the County of Westchester Industrial Development Agency (IDA) for bond financing. Within months, the IDA issued a 30-year, $4.5 million tax-exempt, variable-rate bond. Reconstruction was soon under way. In part, the IDA responded to the potential impact that the new Film Center would have in stimulating the local business community and enriching the cultural life of the area's residents.

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The Jacob Burns Film Center opened its doors a year later. With the facility running, the Film Center has found it easier to raise additional funds. Attracting a wide audience from throughout the region, it has brought new vitality and economic success to the community.

Far-Reaching Advantages

Like the Film Center, a growing number of nonprofits are financing their projects with bonds issued by state, county, or city economic development agencies. Bond financing lets these nonprofits move ahead quickly to construct needed facilities. They can put these facilities into service years earlier than if they raised the funds through a traditional multi-year capital campaign. Nonprofits that launch a five-year capital campaign often find the campaign stretching to six or seven years or even longer. By the time the funds are raised, an originally estimated $4 or $5 million capital project may have increased to $8 or $9 million or more because of the 10%-15% compounded annual construction cost increases. Traditional capital campaign fundraising efforts rarely catch up with the cost creep.

Although the chief benefit of bonds issued through economic development agencies is a low interest rate compared with conventional borrowing, they offer other benefits as well. The bonds are typically issued with a 10 to 30 year maturity, and their interest rate may be fixed or variable (floating). In addition, this type of financing often brings with it certain tax abatements and economic incentives such as reduced energy costs. As capital market instruments, bonds often have more flexible terms than comparable bank loans. Because the interest paid to bondholders is exempt from income taxes, the bonds are highly marketable to individual and institutional investors in high tax brackets, particularly where they may be taxed on three levels — federal, state, and local.

You would do well to consider bonds not only for capital projects but for other uses, too. For example, you can use bonds to refinance your organization's debt, a fact especially useful in an era of volatile interest rates. ■

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More on Planning Your Capital Project

See these *Nonprofit World* articles (www.snpo.org/members) for more advice on planning your cap project:

The First Capital Campaign (Vol. 6, No. 1)

Are You Ready for a Capital Campaign? (Vol. 12, No. 5)

A Strategy for Capital Project Success in a Tight Economy (Vol. 22, No. 3)

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