

Board Subcommittee Report on Financing Bard Hall Reconstruction

Background

A subcommittee was appointed during our October 21st Board Meeting to gather information and respond to questions raised about our congregation's ability to successfully service the debt associated with a \$2 million loan to reconstruct Bard Hall. Iris Masotti, Eric Karpinski, and Susan Weaver were appointed. We began our research, knowing that our congregation pledged \$2.6 million for the Bard Hall reconstruction project with the understanding that it could be contributed over a three-year period. Another \$200,000 is anticipated from a bequest, for a total of \$2.8 million, requiring a \$2 million loan to finance the \$4.8 million building project as proposed.

Our next step was to request a meeting with CRT plus additional Board members, Jan Garbosky, Dave Hunt, our ministers and the Director of Operations so that we could discuss the financial aspects of this important project and ask questions about the design and features recommended by the CRT and consultants for a new Bard Hall priced between \$4.3 and \$4.8 million.

The CRT met on November 11 with Board members Jan Garbosky, Iris Masotti, Connie di Girolamo, and Susan Weaver, and as well as Karen Walter, Arvid Straube, Kathleen Owens and Michael Walker. Updated construction options were presented for discussion. The group generally agreed that construction of the second story as a "warm shell" would not meet the space needs for the Congregation. Although there was an option to build a two-story building for \$4.3 million (including the patio renovations and excluding parking lot improvements), many questions remained unanswered with respect to its features and design. The CRT members recommended that rather than simply choosing one of the options presented, it would be more appropriate to decide how much is prudent and reasonable to finance and then consult with Swinerton as to what two-story building could be built within that budget.

After much discussion concerning what financed amount could be covered by increases in annual pledging, or an increase in current pledge units, or a combination of both, the lay members of the CRT reached a consensus to recommend to the Church Board that First Church obtain **financing up to the amount of \$1,500,000** in order to construct a fully useable two-story replacement of Bard Hall and renovate the Church patio area, based on designs already submitted. It was further recommended that Karen Walter convey to Swinerton that the **maximum amount the Church could afford to pay was \$4.3 million**, and direct them to design and build such a two-story building. The CRT would exercise its responsibility to justify expenses and Swinerton would be responsible to the Church through its Director of Operations.

Financing the Construction

The following is a summary of the financial issues raised, ideas explored, and information evaluated by the subcommittee with consultation / information from Karen Walter, Rev Kathleen Owens, Rev. Dr. Arvid Straube, Suzette Southfox, Ed Law, and Jim Faris. Dave Hunt provided extensive historic information that has been emailed to the Board. The Subcommittee researched and discussed the complex factors that may help or deter us in loan repayment, developed assumptions about our ability to make payments over time, and factored our findings into amortization tables after obtaining general information from three banks.

Why Bard Hall, Why Now?

The cost of continual repair to the old building is staggering. Rooms available for member meetings are extremely tight and further loss of meeting space will reduce program and the potential for member growth. Considerable time has been devoted to assessing member needs and wishes in our building design, architectural options, green features, required permits, and member / staff / school needs during the construction phase. To date, approximately \$435,000 has been invested in the planning and design of the campus renovation. Our prior delay to incorporate more space and member wishes in the design increased project costs dramatically. We have been told that it is unlikely the costs will decrease, even in this economic downturn.

Responses from a sampling of members lead us to believe they feel that the new Bard Hall will be one of the lynchpins of the growth of this congregation. The new building will be a source of pride for the congregation and visitors. As members, we'll want to bring our progressive friends here for social programs and Sunday services.

The successful planning, funding, and opening of our South Bay Campus, implementation of creative ideas for welcoming guests, and methods introduced for new member orientations have created an unmistakable energy and excitement within our church community. There is increased visibility in the broader community due to our extensive volunteer efforts on behalf of Prop 8. Members pledged the \$2.6 million because they understood the need for a usable, inviting and reliable space that serves their needs and the work of the church. After considering a suggestion to postpone the congregational vote until after the next pledge drive, the subcommittee strongly concurred that further delay of the project would have serious ramifications including increased costs as well as reduced momentum and confidence.

The ministers, staff and board understand the enormity of the task of *increasing* our total pledge income by between \$110K-\$135K annually and/or find other income options. We must effectively communicate to the congregation, ahead of the vote, solid information about the seriousness of the commitment as well as the need for a new Bard Hall. We have never increased our giving to such an extent in such a short time in our history. Should we vote to move ahead with the current Bard hall plans, the board and church leadership need to commit to fully supporting all the activities of Generosity Committee and the pledge drive to achieve these challenging goals.

Historic Information

It is important to be aware of our history when developing assumptions about the future. Dave Hunt compiled an excellent and thorough historic assessment that all should read. It includes graphic and written information, over time, about pledging, Sunday service attendance, and other financial issues, along with conclusions he draws from this information. Dave's document will be emailed to all Board and CRT members.

Looking Forward

The following information is provided with the goal of aiding the Board and ultimately the congregation with an important decision about our future – it includes financial information, growth estimates, loan costs, barriers to repayment, and ultimately the sacrifices that need to be clearly understood if we assume this obligation. A list of expense and income assumptions is included. First, let's look at an estimate of costs associated with a loan.

Loan Options

Preliminary discussions have been held with three banks -- San Diego National Bank (SDNB), Wachovia, and Comerica. Although specific information must be provided to a bank in order to obtain precise interest rates and fees, we were able to learn the following:

After receiving a line of credit for the construction stage, during which time only the amount needed is drawn down, we would convert to a loan or mortgage. Wachovia tentatively offered a fixed interest loan at perhaps 6.5% plus approximately a 2% fee spread over the 30-year period – and with no penalty for early pay back after the first few years. If an annualized mortgage is actually available to us at the time we are ready to proceed, it represents less than 30% and perhaps 25% of current annual parking lot income.

The bank offered considerable flexibility and help in planning to meet our needs. Interest-only payments for initial years and ARMs were possible, but not suggested. Tax-free bonds were discussed, but they were both costly and time-consuming to establish, and used more widely in loans upwards of \$5 million.

A senior officer of Wachovia met with Betty Boone, Iris Masotti, Karen Walter, and Susan Weaver on November 12th to tour the campus and answer questions. From our initial calculations using online amortization tables for loans to meet our needs, using 6.5% interest rates as an estimated base and including

a 2% loan fee, it appears that we should plan an annual cost of between about \$116,000 (up to \$135,000 if interest is higher than anticipated when authorized). The range is being tightened as we meet with bankers. Interest-only or other loan products could reduce initial costs and will be explored.

Areas of Inquiry or Research

The subcommittee explored a long list of issues that we deemed pertinent to successful acquisition of a loan and our ability to repay it over time.

- **The Economy and Capital Pledges**

Assessing the stability of a major portion of the dollars pledged to the Capital Fund seemed to be necessary. It was determined that major donors would be contacted by phone to talk in general terms about how each is doing and to obtain assurances that they would notify our ministers *if* they become unable to pledge the full amount within the designated time frame. Ed Law agreed to help us. The group represents 57% of total dollars pledged. His discussions will help us gauge the level of confidence from these members regarding the security of receiving dollars pledged. To date, no members of the congregation have indicated they must change amounts pledged to the Capital Fund.

- **Needed Repairs and Deferred Maintenance**

The Bard Hall renovation will resolve many of our maintenance issues. There will remain some additional deferred maintenance projects. Southern Cross Property Consultants addressed those issues at the August Board meeting, and Karen Walter has reviewed those needs. Karen would prioritize the projects as follows (these estimates are subject to change):

2009-10: asbestos abatement project in RE building (\$25,000)

2010-2011: refurbishing the RE classrooms (\$15,000) (cosmetic repair)
window replacement in the Chapel (\$30,000-45,000?) (energy inefficiency)

2011-2012: stucco repair (could eventually lead to mold) and trellis replacement (\$25,000?)

2012-2013: priorities would include plumbing repair under the RE wing (\$15,000).

This year's major repairs budget is \$23,000. To accomplish all deferred maintenance projects on the timeline and to have a reserve for unexpected repairs will require an increase in that budget item (particularly with respect to 2010-2011). For instance, an increase from \$23,000 to \$30,000 in next year's budget would represent a 30% increase. The repairs for 2010-2011, although for cosmetic reasons or energy efficiency, could require an even larger increase. However, none of these projects is expected to become an emergency repair need. Also, it is believed that we will experience significantly lower routine maintenance costs following the construction.

With respect to the Meeting House lighting / wiring issues, these repairs will have to be accomplished slowly, one segment at a time, as the Operating Budget allows.

Wrapped into the Bard Hall project will be replacement of the gas supply on the RE roof and elimination of the plumbing/sediment issues in that area. It is believed that we will experience significantly lower routine maintenance costs following the construction.

- **Operational Budget / Income**

We have learned that the average and total amounts pledged have increased significantly since 1997, while the number of members pledging has declined, partially perhaps due to members leaving or not continuing active participation along with a sizeable number who choose not to contribute. Therefore, member retention with active participation along with finding effective ways to reach those who are not pledging become important elements in forecasting future income. Most important, however, is member

growth. We asked staff to develop a thoughtful calculation of expectations for new members. A summary of our exploration of these areas follows:

Member Retention: Susan Harding, Suzette Southfox and others are focusing on welcoming visitors, scheduling good member orientations, linking new members with activities or groups that fit their interests and needs, mentoring, offering special welcomes in Sunday services etc. They hope to reduce the number who leave or feel unconnected while engaging those who express interest or have become members.

Reaching those who don't pledge: Naturally some members find themselves in a position of being unable to contribute either temporarily or permanently. Some do not pledge, but contribute periodically. Development of good general education / communication materials and other creative ways of reaching these folks will be a challenge that we are confident will be addressed. Membership brings many benefits along with a responsibility to pledge, when feasible.

Member Growth

Suzette estimated the new individual members for the coming year by using the current new member surge, taking into account the new So Bay campus and the Saturday service – along with focused membership push and resignation prevention strategy. She is confident we can include 90 new members, or 75 net. To calculate the death/resignation number, she used 2007-08 figures (14 resignation, 3 deaths), and slightly adjusted for positive growth to get a total of 15. She then used both of these numbers and increased new membership by 25% and increased resignation / death by 5. She estimated membership net growth for the coming 5 years at 8% annually. We will make some assumptions about converting "individual" member's numbers to pledge "units" and estimate potential income from this growing population at the Board meeting.

Annual Pledging

We may find that some members are unable to meet their full pledge obligations during these difficult times. Jim Faris reports that a few members have reduced their pledges or have indicated they might not be making their regular payments for a while, though they did not want to adjust their pledge amounts at this time.

Parking Lot Income

We currently earn about \$500,000 annually from public use of our parking lot. It increased about 11% during the past several years, primarily due to use of Ace to monitor it. We estimate the rate of increase will plateau to approximately 3%, or cost of living, in future years.

Endowment Income

Our Endowment income projected for this year's budget is \$29,500. The Church's annual income from its endowment is 5% of the rolling average for the prior 13 months of the value of the account. Endowment Fund income will likely decrease during the economic downturn.

Contingency Planning

In making this decision, it is important that we understand the ramifications of not raising the amount needed to repay the loan for months or longer periods of time. While we are not risking the loss of the church land or buildings, there would need to be significant budget cuts to make our loan payments. Arvid and Karen have looked at the numbers and here are a couple of scenarios:

1. Should we come up \$50K short of our fundraising goals, we will need to cut all discretionary spending from our budget for the period of years until we can make up this shortfall. This includes cutting all GA subsidies, foregoing UUA dues for a time and significantly cutting back on program budgets. There would be a lot of "kicking and screaming" to get to this budget, but no staff or significant programs would be cut.

2. Should we come up \$100K short of our fundraising goals, there will be no option but to cut one or two staff positions and a majority of the programs that go with that staff. Our programs are our inventory and loss of programs like this would significantly limit our ability to grow until we can make up that income. We need to avoid cuts of this depth if at all possible.

Funds Available for Short-term Only

We considered options that might be tapped in the event we encountered a *short-term* decrease in revenue or an unexpected increase in costs? One option we explored that could be used was a loan from one of our Funds, with repayment of principle and the interest it would have earned.

The Recommended Construction Estimate and the Cost of Debt: Our Challenge

If the CRT recommends a construction scenario with a \$4.3 price tag for example, and we find our annual debt service to be approximately \$135,000 annually, how can we find funds to pay it? Where might we look? What are the challenges and risks? Can we afford not to proceed? Difficult questions!

Financial Assumptions:

Expenses

ANNUAL OPERATING EXPENSES

Operating costs will likely increase annually at about 6% for several years before decreasing to approximately 4% annually.

MAJOR REPAIRS

We learned that it is unlikely that the RE and Administration buildings will require *major* overhaul in the next 8 years or so. However, we would want to increase the major repair fund by 30% or \$7,000 during the next two years to take care of problems in a timely way. The property income, described below under donations, produces about \$8,000 currently and is expected to grow gradually, especially after this economic downturn. Income might be used to build the major repairs fund for several years before being diverted to other general expense categories.

Income

SPACE USAGE FEES

When the building is completed, some space will be offered for use to non-member groups. Previous income derived from non-member groups was \$30,000 annually. In 2011, \$8,000 in income is anticipated, increasing to \$20,000 over 6 yrs. before perhaps leveling to a 3% annual increase through 2031 when member growth may preclude use by non-members during last ten years of loan.

DONATIONS

A member recently donated a percent of income derived from property. Many units in the building are currently vacant, which is abnormal, but it will still produce about \$8,000 in income for us this year and next. We estimate an 8% annual increase starting in 2011 through 2015; then 5% annual growth, decreasing to 3% in 2025.

INCOME FROM NET MEMBER GROWTH

We will likely see a net increase in member growth this year of 75 members. Estimates of growth suggest substantial new member net increase through the 2014-15 fiscal year. However, we need to be cautious in assumptions about pledge levels during the next few years. Additional growth assumptions will be discussed during the Board meeting.

BEQUESTS

Although one cannot project income levels or timing of income from bequests, it is important to note that bequests have *averaged* \$50,000 / year. Subject to further verification, we believe that the Channing Society

has **174 members**. These periodic gifts may allow us to consider using dollars received in the future for early pay down of the loan.

PARKING LOT

Lot revenue is currently \$500,000 / yr. 17 spaces will be withdrawn during construction for storage of equipment. Pledges, gifts, and the parking lot are our primary areas of income. We estimate the lot income will increase at about 1.5% annually after construction.

Income Producing Possibilities

The current 452 pledge units contribute \$683,665 or \$1512 annually. We will encourage members to pledge at Fair Share Giving Levels. Pledging, when feasible, is a member responsibility.

- A possible scenario is to increase pledges by twice the cost of living increase, which would add an additional \$45,000 annually. Obviously this will not be feasible for some, though the Fair Share model should be for most. It's merely a way of calculating the possibility.
- The "In-lieu-of-Starbucks Donation" (or equivalent treat): Let's estimate that 700 of our 1000 members are physically active and able to contribute. In addition to a pledge, could we ask them to help build Bard Hall in this way: Obtain a Starbucks (or other empty container), and in lieu of buying something like a Starbucks once a week, place the \$2.50 in the cup (certainly less than a Tall Decaf Mocha). The income from this action would provide \$71,000 annually.

Retention: It would seem we could reap \$10,000 annually IF we could retain half of those that we lose.

Reaching a % of non-pledging members: There are about 150 "pledging units" currently not pledging, although some are financially unable to do so. If 100 of this group, for example, were able to pledge something and we encourage 1/2 (or 50) of those to become willing pledgers at a rate well below the current median rate of \$900, say \$650/ annually, we would increase income by \$32,500.

The Likely Cost of Inaction:

Everyone we have talked with, including the ministers and staff, believes there is a feeling of renewed excitement about First UU. Perhaps it is due to the work of so many UU volunteers and community connections made during the Prop 8 and Presidential vote, the apparent success of South Bay campus, the dynamic sermons and wonderful music. Our intentional welcoming ideas are becoming a good habit. These are difficult concepts to price in terms of income, but we do believe there is a correlation to future growth.

The congregation, staff, CRT and Pledge Drive members have worked diligently to plan for a new space that is appropriate for our needs and for growth. To delay or to recommend a one-story building to replace Bard would cause, we believe, considerable negative feelings. More importantly, a one-story building on the footprint available would not meet current or future member needs.

We believe that a two-story building, usable from the start, could be designed to meet our ability as a congregation to pay for its construction IF we stretch and can count on the support of all members who can contribute.