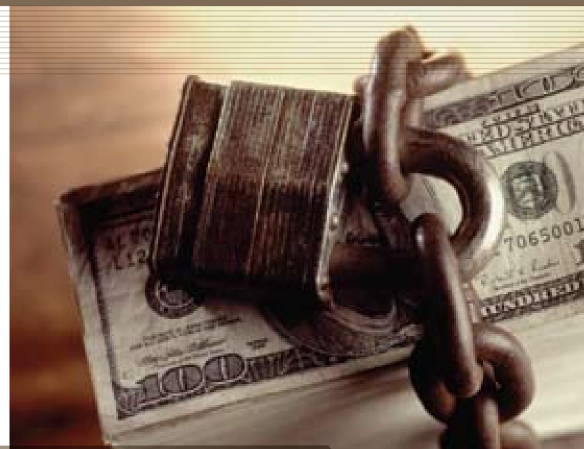

The Credit Crunch: Implications and Opportunities for Nonprofits

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Even though we are still hesitant to label our current economic downturn a recession, domestic and international financial markets are clearly in turmoil. There are serious concerns in both the equity and fixed-income markets regarding liquidity and the "credit crunch." Access to credit, which has been free flowing in recent years, has been restricted as the market for selling residential and commercial mortgages through securitization has become severely restricted, thereby cutting off a major source of liquidity for mortgage lenders.

The Federal Reserve's January 2008 *Senior Loan Officer Opinion Survey on Bank Lending Practices* confirms the changes in residential and commercial lending practices and pricing in late summer 2007. This quarterly survey noted that "domestic and foreign institutions reported having tightened their lending standards and terms for a broad range of loan types over the previous three months." The survey also noted tightened lending standards, higher pricing for credit facilities, and increased credit spreads for riskier loans. The Fed's *Beige Book* report released January 16, 2008 also noted credit tightening in the 12 Federal Reserve Districts nationwide, saying that "....most Districts cited tighter credit standards."

The nonprofit world is not immune to the various implications of the ongoing global credit market disruption. Lenders and investors are tightening their underwriting standards particularly for borrowers without strong credit characteristics. As a result, behavioral healthcare provider organizations are seeing some distinct trends and opportunities described below.

Greater Equity/Lower Loan-to-Value Requirements

Lenders are requiring greater equity positions in their underwriting of commercial loans. As real estate values stagnate, in contrast to the sharp increases over the past decade, lenders are more closely scrutinizing appraisals and becoming more conservative in their evaluations of property values. The result is a need for greater equity stakes by borrowers in real estate being acquired or refinanced.

Wider Risk Premiums

The credit spread between the highest quality commercial loan rates and loans of lesser quality is increasing considerably as lenders have become more averse to risk. Although rates have generally declined as a result of the Fed's recent actions, lenders are requiring higher risk premiums to compensate for greater perceived credit risk among borrowers. As a result, most borrowers will only realize a portion of the decline in rates. The credit spread between the highest quality commercial loan rates and those for loans of lesser quality are increasingly considerably as lenders have become more risk averse.

More Stringent Covenants

Lenders are requiring more stringent financial and operating covenants, including higher debt service coverage ratios, greater liquidity (i.e., days cash on hand), and more onerous requirements for the future issuance of additional debt. Tighter covenant requirements place limitations on borrowers' operations and options for accessing capital in the future. Operationally, the ability to establish or expand services can be restricted by the need to meet lenders' ongoing profitability and cashflow tests.

Declining Real Estate Prices Create Growth Opportunities

Stricter lending standards and recessionary fears are beginning to translate into fewer buyers for real estate assets in many markets nationwide. Nonprofit organizations with long-term programmatic and strategic needs for real estate assets (residential property for supported living programs, office space for operations and programs) can take advantage of the bursting of the speculative bubble in many communities to acquire property at attractive prices.

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Unfamiliarity with Nonprofit Borrowers

Another longer term consideration for organizations seeking capital is a general lack of familiarity with and understanding of the operations and financial characteristics of the nonprofit world on the part of many lenders. Organizations that do not fit into a bank's typical commercial lending parameters are often denied credit or receive more stringent terms and higher rates. As a result, few alternatives have existed for providers that do not have exceptionally strong balance sheets or historic operating profitability.

As behavioral health providers struggle to survive and thrive in this troubled economy, they can benefit most by turning to organizations dedicated to funding nonprofits and helping them obtain capital at market rates on reasonable terms.

Dean Adams is with the Community Health Facilities Fund and helps healthcare organizations access capital through tax-exempt bonds and traditional commercial loans. CHFF is funded by the Robert Wood Johnson Foundation and sponsored by the National and the United States Psychiatric Rehabilitation Association. CHFF offers commercial loans for information technology needs and real estate-secured transactions. Go to www.chffloan.org or contact dadams@chffloan.org.