Disclosures About Church Bonds

"Church bonds" are a type of investment available to Stifel clients. The yields on church bonds are attractive when compared to other bonds; however, there are risks associated with owning them, as stated below. Before you make a decision about whether to purchase a church bond, you should consider the characteristics and risks of a typical church bond to determine whether a church bond investment is consistent with your investment goals. Your Stifel Financial Advisor will provide you with more information about the characteristics and risks of particular church bond investments.

The Typical Church Bond

While each church bond is unique, church bonds do share many common characteristics. The typical church bond is issued by a single religious institution. While they are commonly referred to as "church bonds," the bonds could be issued by an institution of any religious faith or denomination.

Each bondholder receives a fixed rate of interest semiannually. Principal is returned to the investor at the bond's stated maturity, unless a portion or all of it is prepaid earlier through sinking fund payments made by the church. Interest is taxable for federal and state income tax purposes, and there is no charitable deduction for investment in a church bond. Church bonds are not rated by a credit rating agency. The principal source of payment of debt service is collections from church members. The bonds are a general obligation of the church and are secured by a first mortgage on the church property. At issuance, the principal amount of the bonds versus the value of the church property (known as the "loan-to-value ratio") will not exceed 75%. Please note, however, that in some cases the loan to value ratio is based on book value (the original cost of the church plus improvements, minus depreciation), which may be less than an appraised fair market value. Each week (or monthly in advance), the church is required to make payments into an account with the bond trustee (known as a sinking fund) so that adequate funds will be on hand to make timely payments of principal and interest. The bonds are issued at par (100% of their principal amount) without accrued interest, and the church may redeem the bonds at par on 15 days' notice.

While church bonds are issued at par, they may not continue to trade at par or be marked on your statement at par. As with any other fixed income security, credit changes and interest rate changes may affect a church bond's price post-issuance.

Risks of Owning Church Bonds

Lack of Liquidity. The most important risk to understand about church bonds is that they are largely illiquid. That means that the bonds do not trade frequently and you may not be able to sell your bond or sell it at a favorable price when you need funds. While Stifel may choose to do so, you should not assume that Stifel will buy your bond when you want to sell it. Some state regulators may place restrictions on trading church bonds in the secondary market, and in some instances, church bonds may not be traded without your state commissioner's consent. Please consult your Financial Advisor for additional information on such restrictions. You should assume that you will need to hold your church bonds until they mature. If you want to sell your bonds before maturity, there is no assurance that you will recover your investment.

This lack of liquidity is factored into the price of church bonds. They frequently bear higher yields than other investment alternatives. However, you are encouraged to consider church bonds as only one component of your investment portfolio, generally no more than 20%.

Inadequate Collections From Church Members. Certainly, inadequate collections from church members are a risk. During times of economic stress, collections may be reduced. Also, attendance at church services or the number of church members may be reduced. One way risk is mitigated is known as "debt service coverage." Historical collections and projections of future collections are analyzed, and annual debt service is sized to project a surplus of collections over debt service. Please note that there is unlikely to be a third-party feasibility study.

Public Health Emergencies Could Negatively Affect the Church's Operations. Regional, national, or global public health emergencies, such as the outbreak of the global COVID-19 pandemic, could have materially adverse regional, national, or global economic and social impacts causing, among other things, the promulgation of local or state orders limiting or prohibiting gatherings and public meetings in such places as church sanctuaries. The operations of churches in the United States have, in certain cases, been negatively affected by these measures, including the decline in collections from church members. Accordingly, no prediction can be made on the effect any public health emergency may have on the finances or operations of a church or whether any such effects will have a material adverse effect on the ability to support payment of debt service on the church bonds.

Loss of Church Tax-Exempt Status. There is a risk that a church could lose its tax-exempt status. While the interest on church bonds is not tax-exempt, loss of the church's tax-exempt status could cause some church members to reduce their contributions because they would no longer be eligible for a charitable deduction. Reduced contributions would, in turn, reduce debt service coverage.

Departure of a Popular Pastor. In some cases, a decision by a popular pastor to leave a church may also affect church membership and, therefore, church collections.

Redemption Risk. Investors frequently purchase church bonds because of their high yield compared to other types of investments. However, church bonds may be redeemed at par on 15 days' notice. In times of declining interest rates, churches may decide to exercise that redemption right and you may lose that high yield. Also, many churches choose to pay their bonds early. The risk that you might not continue to receive an attractive yield for as long as you might have anticipated due to a church's decision to pay its bonds early is referred to as "redemption risk."

Default Risk. While historically the default rates on church bonds have been low, some defaults have occurred. Stifel endeavors to underwrite church bonds in a conservative way to minimize the likelihood of default. Among other things, the churches whose bonds we underwrite will have audited financial statements. Few defaults have involved the failure to pay principal or interest; however, in some cases, churches have not made their sinking fund payments in a timely manner. That is also considered a default until cured. When you are considering buying a church bond, your financial advisor will inform you whether bonds of that church have defaulted in the past.

Bankruptcy Risk. Bankruptcy of the church is also a risk. While the bonds are secured by a mortgage on the church, the bondholders' rights to foreclose on the property might be adversely affected by the bankruptcy proceeding. There can be no assurance that the proceeds from the sale of the church property will fully cover the remaining bonds outstanding. That is particularly the case if the bonds are used for new construction and the facilities are not completed as anticipated. Also, churches are generally considered to be single-use properties, and that may affect their value upon foreclosure. The original loan-to-value ratio of 75% may be based on the original cost of the church, plus improvements, minus depreciation. That may be less than appraised fair market value at the time of sale.

These and other risks of church bonds will be described in the prospectus for particular church bond issues. Please remember to read the prospectus for the particular church bond you are considering buying. The characteristics and risks of that bond will be described in the prospectus and may differ from those of the typical church bond.