BAPTISTS HELPING THEMSELVES: RELIEVING STRUCTURAL CREDIT BIAS AGAINST NEW ZEALAND BAPTIST CHURCHES THROUGH A FINANCE SOCIETY[1]

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The Baptist Savings and Development Society (BSDS hereafter) was established in 1962.[2] BSDS takes deposits and makes loans, largely within the community of the Baptist church movement in New Zealand. Initially operating on a very small scale, BSDS was part of a significant expansion of the NZ Baptist movement by providing finance for the purchase and development of church properties, particularly in the 1960s and 1970s. BSDS currently holds over NZ$100 million in deposits, with a lending book of corresponding size (see "Historical outline" below).

For all the apparent success of BSDS, it might seem rather odd that BSDS exists at all. There are huge economies of scale in financial services, and so on the face of it a small institution such as BSDS ought to find it difficult to compete with larger, mainstream banking institutions.[3] If it is economically worthwhile for BSDS to engage in its financial activities, then this might indicate a degree of opportunity for the mainstream banking sector. Despite this, the vast majority of Baptist churches in New Zealand use BSDS for their borrowing needs, and the vast majority of depositors in BSDS come from churches (institutional and personal deposits).

It would appear that BSDS is able to provide a niche financial service to both depositors and lenders that has enabled not only successful operation but sustained growth. In this study, we focused on the attractiveness of BSDS to borrowers as this is a key to the success of any lending institution. We asked three questions about the initial formation and subsequent operation of BSDS:

1. Did BSDS provide credit to Baptist churches which encountered difficulty in obtaining credit from mainstream banks?

2. Did BSDS provide credit to Baptist churches at lower prices than they could access in the mainstream banking sector?

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[1] This research, carried out in early 2015, was made possible by a grant from BSDS which covered expenses and time for the principal and assistant investigators. The research depends on contemporaneous archive documents and personal interviews (see "Methodology" below), which are cited by reference to appendices in the full research report available by email request from the first author (lyndon.drake@theology.ox.ac.uk).

[2] BSDS consists of several entities, described in their Product Disclosure Statement. In this article, we have relied on the Replacement Statement dated 30 April 2015. Note that BSDS was originally named the New Zealand Baptist Development Society (NZBDS Inc.), and references to earlier periods of BSDS's operations often use this name.

[3] For clarity, we use terms like "mainstream banking" to refer to the large, well-known deposit-taking banks in the New Zealand economy, such as ASB, BNZ, etc. The New Zealand financial services sector is relatively complex for its size with many finance companies providing services which mirror those of traditional clearing banks, including deposit-taking and a range of lending activities. No single term easily distinguishes these kinds of institutions from each other but in practice, mainstream banks are recognisable by their large branch network, financial scale, and systemic importance.

3. Did BSDS provide credit flexibility beyond that generally available in the mainstream banking sector?

For each of these three questions, an important issue was identifying whether BSDS remedied a structural bias against New Zealand Baptist churches in the mainstream banking sector. We also considered the factors influencing BSDS's commercial viability.

METHODOLOGY

To answer these questions, we examined three main sources of information:

1. Contemporaneous documents. BSDS was established by the Baptist Union of New Zealand, and was preceded in some of its functions by another Baptist credit-providing entity, the Jubilee Fund. The official minutes from the Assembly Council of the Baptist Union of New Zealand, from the board of BSDS (initially these two groups were identical), and prior to the establishment of BSDS the Jubilee Fund, all record information about the intentions and practices relating to the establishment and operation of BSDS. In some cases, this information was supplemented by further records kept by BSDS, such as loan documents and financial reporting. This documentary information forms the primary and most significant source material for this article.

2. Publicly available information. For comparisons of current rates paid on deposits and charged on loans, and historic comparisons, some publicly available information was used, much of which was already published and some of which is made publicly available upon request. For example, BSDS publishes its deposit rates on its website, and these are easily comparable with published deposit rate information from the mainstream banking sector. The interest rate currently charged by BSDS was obtained directly from email contact with BSDS and similarly can be compared with the rates that mainstream banks charge to charitable organisations (mainstream banks differ in their practice: some publish the rate on their website, and others supply it on request).

3. Personal interviews. We interviewed a small number of those involved in the establishment of BSDS, including in two cases in-person recorded interviews. We have not used information from the interviews to establish any single point, instead relying on it for clarification and confirmation of contemporaneous documentary information and publicly available documentation. On occasion, for example in the period where BSDS expanded rapidly during the 1970s, information from personal interviews has proved significant in explaining the feasibility of the contemporaneously documented situation. In interviews, we asked neutral questions about the availability of credit, pricing of credit, and operations of BSDS.

In assessing data from these sources, we have given the greatest weight to the first two categories, as these are less subjective than the personal recollections of individuals, no matter how carefully expressed. Additionally, the first two sources are verifiable, and to make verification more feasible should the need arise we have scanned and electronically collected the primary source materials used for sources of the first and second categories. To aid verification of the third category, electronic communications, notes, and voice recordings of interviews have similarly been collected, but of course verification of these sources is inherently limited to accuracy of transmission from the interview subject as the events being recalled are in many cases decades old.

On material questions, we have only drawn conclusions that can be supported by the first two, more objective, categories of evidence.

HISTORICAL OUTLINE

The Jubilee Fund of the Baptist Union of New Zealand was founded at the Jubilee Conference[4] held in Christchurch in October 1932, with the intention of making gifts and interest-free loans to Baptist churches to "aid local efforts in reduction of existing debts, or to assist new extensions of work."[5] The start of the Jubilee Fund was made possible by the Auckland Baptist Tabernacle Trust Fund,[6] which gifted £500 and then matched donations to the Jubilee Fund pound for pound. Another existing fund, the Auxiliary Contingency Fund ,was also transferred to Jubilee fund for the Gift part of the Fund. The Fund made loans, exclusively to finance properties held in trust by the Baptist Denomination. As noted in November 1932,[7] the main idea of the Fund was to use the capital on a circulating loan plan, which made loans free of interest, for the purpose of (Baptist) denominational progress. Claims on the Fund could be made by schools or churches. The Jubilee Fund was successful but small in scale, making 17 loans by 1935 and continuing at a similar rate over the following years.[8]

While the Jubilee Fund continued (and in fact still exists today),[9] in 1962 the NZ Baptist Development Society was formed. From its inception, it offered interest-bearing deposit accounts and charged interest on loans. The commercial proposition of NZBDS was built around paying competitive rates for deposits, while offering loans to Baptist churches on beneficial terms to those which could be obtained in the commercial banking sector.

While initial growth during the 1960s under Ray French's management was relatively slow, NZBDS was able to finance considerably more than the Jubilee Fund. In 1986, when Maurice Cavaney took over management, the loan book was sitting at around $1m, and expanded under his tenure to over $60m, even under the constraint of a conservative lending policy.[10] Since then the loan book has grown further, partly through the purchase of the loan book and deposits from Presbyterian Savings (a similar institution), and

[4] The Jubilee marked 50 years of the Baptist denomination operating in New Zealand.
[5] From the Jubilee Fund Letter announcing the establishment of the fund (see Appendix D. 1.1).
[6] As it was then referred to; under the Auckland Baptist Tabernacle Act 1948 it became the Auckland Baptist Tabernacle Trust Board, and currently operates as the Tab Trust.
[7] Appendix D. 1.2.
[8] Appendix D. 3; note that in the initial years of the fund, the maximum loan amount advanced was £100.
[9] In fact, the Jubilee Fund, along with two other relatively small funds (the Dawnian Fund and the Peninsular Fund) are both administered by BSDS. All three funds make relatively small, unsecured loans, generally at an interest rate of inflation plus 2%; in other words, well below commercial lending rates.
[10] See Appendix B. 2, paragraph 3. The BSDS *Product Disclosure Statement*, 14, outlines the segmentation of the loan book by loan-to-value ratio for both commercial/predominantly commercial and residential/predominantly residential property, and notes that as of April 2015, both sections of the loan book could withstand a 25% property market fall without inducing a negative equity situation for any borrower. Current policy is a maximum LVR of 80% for lending against residential property, and 60% for non-residential lending (BSDS Administration Manual §1.2.2; see Appendix A).

the loan book now stands at over $100m.[11]

RESULTS

We present two main areas of findings. The first is around the provision of credit to New Zealand Baptist churches, including the availability of credit, and credit pricing. The second is around the commercial viability of BSDS, where we briefly explain some of the factors that have enabled BSDS, since its inception, to provide financial services to New Zealand Baptist churches.

Provision of Credit

We found that BSDS has been able to offer greater credit availability, at cheaper rates, than the mainstream banking sector.

Credit availability

At its formation BSDS offered credit only to NZ Baptist churches and other NZ Baptist groups, a policy which has only recently been modified[12] and which still describes the majority of the BSDS loan book.[13]

The main opportunity in the financial market for BSDS has arisen from the reluctance of the mainstream banking sector to offer sufficient credit to New Zealand Baptist churches. This reluctance to advance credit is observable in instances from the minutes of the early years of the Society, which show that banks would on various occasions only advance short-term finance (when the need was long-term), would not renew existing lending, would only lend part of the funding required, would only advance long-term finance (when the need was short-term), were unwilling to lend against future grant funding income, or would simply not offer credit at all.[14]

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[11] BSDS *Product Disclosure Statement*, 15, 22. The purchase of the PSDS loan book was prompted by regulatory changes which simultaneously made it practically impossible for PSDS to continue trading, and made it attractive for BSDS to significantly increase the size of its loan book. The overall expansion in lending to churches was at least in part due to increased property valuations making LTV ratios attractive, and (anecdotally at least) increases in population and expectations of church buildings prompting churches to undertake property development work.

[12] This took place in 2013 (see BSDS *Product Disclosure Statement*, 15).

[13] See BSDS *Product Disclosure Statement*, 15: "we now have over $19 million in non-Baptist lending, which is over 25% of our total lending at the date of this PDS and we expect this to increase further." Some of the Baptist lending is to Baptist charitable causes rather than churches.

[14] For example, in 1966 Mornington Baptist Church was only able to obtain temporary finance for a manse from mainstream banks (Appendix E. 1.3). In 1968, Wellsford Baptist Church was unable to renew an existing bank mortgage for $10,000 (Appendix E. 1.1). In 1967, Matamata Baptist Church was only able to raise $2,100 of the $7,800 cost of four land purchases through donations and bank borrowing (Appendix E. 2.1). Mt Albert Baptist Church (in 1964; see Appendix E. 2.3), Northcote Baptist Church (also in 1964; see Appendix E. 2.4), and Ashburton Baptist Church (in 1967; see Appendix E. 2.2) were all able to obtain a bank mortgage but not short-term financing. On other occasions BSDS provided short-term financing to churches selling properties when they were unable to find short-term financing through mainstream banks (Appendix E. 5.9). Around the same time, the Otago Southland [Baptist] Association needed a short-term loan in advance of Department of Health Funding (Appendix E. 5.4). The First Annual Report (1963) noted that "Loans made have in many cases supplied finance not available through normal lending channels" (Appendix E. 5.12), a 1964 letter to church secretaries noted that the Society could help by "bridging the gap between building costs and the amount of mortgage and other funds available" (Appendix E. 5.11), and the Secretary of the Society noted in an undated letter from this early period that "The cost of new buildings exceeds the

Given the fact that over BSDS's history, there has been a low default rate on the loans it has made (see §4. (b) (i), "Credit restructuring"), the New Zealand Baptist churches are clearly (in hindsight) an excellent credit risk, and should in theory have been able to access credit easily through the mainstream banking sector.[15]

At the point of loan origination, however, mainstream banks have made negative *a priori* assessments of the credit and reputation risks involved in lending to New Zealand Baptist churches. Neither of these two aspects of risk assessment indicates a malign bias against NZ Baptists, but they relate to inherent attributes of NZ Baptist churches and do constitute a structural bias against these churches.

The first aspect of credit risk that affected New Zealand Baptist churches was the lack of suitable assets to offer as security against the loan. Ray French recalls that in the early years of BSDS, at a time when the Baptist movement was expanding, churches often had little they could offer as security, a problem that was exacerbated by the fact that most Baptist churches (and, as far as we know, all the new Baptist churches being established at the time) vested their real property in the Baptist Union of New Zealand.[16] Mainstream banks were understandably reluctant to lend to the church which wanted to develop property, when the ownership of that property was vested elsewhere and unavailable as security.[17] (Some borrowing was to fund the purchase of residential property, e.g. in order to provide a manse for the minister of a church.[18]) The lack of suitable assets to secure loans is an ongoing issue today, as the BSDS Administration Manual notes: "Most of the land and buildings that our loans are secured over are used as churches, so are either purpose built for this or have been adapted to suit that purpose."[19]

The ability of churches to service loans is also difficult to assess at the point of loan origination. Typically, churches are funded by voluntary donations from those who attend the church. Very few churches have independent income streams that are commercially dependable or capable of being assessed in conventional risk terms. People who attend a church are under no obligation to continue doing so, or even to maintain their level of donations to the church, and it is not unknown for churches to shrink rapidly in the number of attendees or donation income (or, for that matter, to grow rapidly). The lack of a predictable

loan finance available through normal channels" (Appendix E. 5.1). It is obvious that different banks and branches responded in inconsistent ways to the common assessment that advancing credit to Baptist churches was risky, given that in some cases they refused short-term credit and granted long-term credit, but in others advanced short-term credit and refused long-term credit. In our opinion, this is like to be because bank branch managers historically had considerably more independence than they do in a modern setting.

[15] It may be that growing awareness of this low historic default rate is causing an increased risk appetite in mainstream banks, as Alistair Maclay noted that the availability of credit from mainstream banks is now higher than it was for much of BSDS's operations (Appendix B. 1, paragraph 2).

[16] See the Baptist Union Incorporation Act 1923, which includes provision for the vesting of real and personal property in the Union. Note that Baptist churches have a different national structure from many other denominational groups of churches. Where other denominations, such as the Anglican church, have a fairly monolithic legal and financial structure, Baptist churches are autonomous entities in a voluntary association. Churches can (and do) join or leave the Union, and in such situations the vesting of the property in the national Union ensures that the property can potentially remain available to the wider Baptist movement.

[17] Appendix B. 3, paragraph 2.

[18] In the case of borrowing to purchase a manse (housing for a church minister), the manse is often suitable mortgage security for a loan. Even for a manse the issue of assessing a church's ability to service a loan secured by residential property remains a challenge for mainstream banks.

[19] BSDS *Product Disclosure Statement*, 13–14.

income stream means that it is difficult for mainstream banks to have confidence in the ability of a church to service a loan.

Lending to churches carries reputation risk to banks because, in the event of a default, it can be difficult to avoid adverse publicity if a bank tries to use the security advanced by a church to recoup its loan loss. For example, if a church has secured a loan on its church building, the local community might become engaged in campaigning against the bank's foreclosure and possible sale of the building, or it might simply result in negative press attention. Maurice Cavaney, who prior to working for BSDS had been a bank branch manager, mentioned that when he worked for the bank concerned he refused lending to churches for precisely this reason. In his view, the potential profit on such a loan was so much less than the potential loss that adverse publicity could produce, that it was not worthwhile for the bank to engage in lending of that nature.[20] Ray French cited a similar situation with the YMCA in Christchurch (for whom he acted in a management capacity), who were refused an extension of credit by a mainstream bank because of the potential negative publicity if a foreclosure resulted.[21] Gaining significant positive publicity from advancing such a loan is difficult, whereas foreclosure on a community asset such as a church building can easily provoke negative publicity. Again, this remains an ongoing issue for BSDS, as noted in their Administration Manual:

> If we enforced a mortgage and sold a building but there were insufficient proceeds to completely repay the loan, we still have the right to sue the church or charity to recover any money owed. While we reserve the right to do so in a particular case, depositors are best to assume that we would not use aggressive recovery strategies such as these against a church community and its members. Thus, if the proceeds of a mortgagee sale were insufficient to discharge a church's debt, then we will likely take a loss from our capital.[22]

The combination of the limited ability of NZ Baptist churches to offer viable security, and more significantly the inability of churches in general to give sufficient assurance to a bank on the income stream, means that mainstream banks may not consider NZ Baptist churches to be a good credit risk.

Price of credit

As well as providing credit where mainstream banks were unable or unwilling to offer it, BSDS has since its formation provided credit to NZ Baptist churches at low cost. Where mainstream NZ banks do offer credit to charitable institutions such as Baptist churches, they typically apply a charge to the interest rate. For example, the ASB charges an extra 1% as a matter of advertised practice.[23]

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[20] Appendix B. 2, paragraph 9.

[21] Appendix B. 3, paragraph 4.

[22] BSDS *Product Disclosure Statement*, 15.

[23] See https://www.asb.co.nz/Business/About-Us/Interest-rates-and-fees/Loans-and-finance (retrieved 11 Mar 2015). The SVR (for residential mortgages) at that date was 6.75%, while the rate applicable to "Societies Clubs and Churches" was 7.75%. By way of comparison, the BSDS rate on 11 Mar 2015 (from http://baptistsavings.co.nz/assets/pdfs/LOAN_APPLICATION_2014.pdf) was 6.45%.

By contrast, BSDS matches the typical residential mortgage rates charged by banks,[24] which gives an advantageous rate to those churches which borrow from BSDS. As Alastair Maclay noted in an interview, while BSDS's price-setting for credit has changed over the years, it has "always lent at lower than commercial rates."[25] We are able to compare BSDS's historic rates with those charged for general residential mortgage lending by mainstream banks using data from the Reserve Bank of New Zealand.[26]

In the early years of BSDS, churches were charged 4% interest,[27] or 3% if they had been established less than five years previously.[28] (In fact, in some cases loans were offered interest-free.[29]) This practice was maintained until at least 1970, as BSDS Board minutes from the 26th of March 1968[30] and 1st of July 1970 refer to the same rates,[31] and on the 29th of March 1969 the minutes record a loan to Bryndwr Baptist Church at a rate of 4%.[32] In August 1969, the BSDS Board minutes record that the Society was looking to extend additional credit because of "heavy mortgages at high interest rates given by banks."[33]

By comparison, from February 1964 (the first period for which data from the Reserve Bank is available) until the end of 1970, the range on residential floating mortgage rates from mainstream banks was 5.7%–7.0%. The BSDS Board minutes from the 1st of July 1970 explicitly mention that "established Churches… would have to pay at least 6 ½ % elsewhere."[34] By 1969, BSDS had made loans totalling $350,547 to 85 New Zealand Baptist churches, saving an estimated $27,542 in interest relative to the price of credit from mainstream[35] banks.

At some point before Maurice Cavaney took over the management of BSDS in 1986, the policy changed for existing churches. Ray French set the rate on loans based on the Post Office lending rate, which was apparently lower than that offered by mainstream banks.[36] Maurice Cavaney would not only survey major banks, but would then "ensure that the [loan interest] rates offered were always at a significant discount to retail rates, and for a great deal of time, new churches could borrow at 3%." [37]

The following table (Table 1) presents a comparison between the interest rates BSDS charged, versus the average residential mortgage rate in the data from the Reserve Bank, as recorded on some representative individual loan agreements from the 1980s and 1990s (comprehensive interest rate data is not accessible). While the examples given here could be multiplied, these instances serve to demonstrate that the policy

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[24] BSDS *Administration Manual*, §1.2.9 and §1.2.10 (Appendix A). BSDS also administers three funds (the Jubilee, Dawnian, and Peninsular funds) which make smaller, typically unsecured loans at around CPI + 2%, or 3.8% at the time of this research (BSDS *Administration Manual,* §2.4.2, §2.4.3, and §2.4.4).
[25] Appendix B. 1, paragraph 3.
[26] The Reserve Bank publishes historic residential mortgage rate data on its website: http://www.rbnz.govt.nz/statistics/key_graphs/mortgage_rates/ (retrieved on 03 June 2015).
[27] Appendix E. 1.4.
[28] Appendix E. 1.5.
[29] Appendix E. 3.5.
[30] Appendix E. 3.1.
[31] Appendix F. 1.7.
[32] Appendix F. 2.1.
[33] Appendix F. 2.2.
[34] Appendix F. 1.7.
[35] Appendix F. 1.2.
[36] Appendix B. 3, paragraph 2.
[37] Appendix B. 2, paragraph 4.

evidenced in testimony was applied during this period.

Table 1

Date	BSDS rate	RBNZ Avg rate	Difference	Church
24-Jun-83	12.00%	17.30%	5.30%	Te Atatu
02-May-88	15.00%	17.30%	2.30%	Royal Oak
15-May-90	13.00%	14.90%	1.90%	Balmoral
01-Jan-92	10.90%	11.10%	0.20%	Mt Albert
14-Feb-94	7.60%	7.40%	-0.20%	Matamata

Note that this comparison does not include the additional loading banks typically charge for lending to churches. Even without taking account of that loading, it seems evident that the BSDS was able to offer credit in line with its stated policy of charging at or less than the average residential mortgage rate offered by mainstream banks.

The largest differential is for the loan taken out by Te Atatu Baptist Church in June 1983 at a rate of 12%, when the RBNZ data shows that prevailing residential mortgage rates were about 17.3%. The headline rate difference is substantial enough, but when one takes into account the effect of compound interest, the actual cost savings arising from BSDS's cheaper credit are strikingly large. Most differences were not as large, and in general BSDS provided credit as cheaply as mainstream banks did to non-church counterparties. In some cases, it provided credit considerably cheaper.

From 2008 onwards, partial data was available from BSDS documenting points at which interest rates were changed. Again, these are presented comparatively versus the average residential mortgage rate in the RBNZ data (Table 2).

Table 2

Date	BSDS rate	RBNZ Avg rate	Difference
01-May-08	9.25%	10.70%	1.45%
30-Nov-08	8.95%	8.80%	-0.15%
30-Dec-08	8.50%	7.90%	-0.60%
28-Feb-09	7.25%	6.70%	-0.55%
30-Apr-09	6.75%	6.40%	-0.35%
31-May-09	6.40%	6.40%	0.00%
31-Jul-09	6.25%	6.40%	0.15%
31-Oct-09	6.00%	6.20%	0.20%
01-Nov-10	6.25%	6.30%	0.05%
01-Jun-11	5.95%	5.90%	-0.05%
19-Jun-14	6.45%	6.30%	-0.15%
25-Sep-14	6.75%	6.60%	-0.15%

The average difference between the BSDS rate charged and the average recorded by the RBNZ is 0.01%, indicating that BSDS closely tracked the average residential mortgage lending rate of mainstream banks. As in the previous section, this does not take account of the effective discount offered by BSDS, by not imposing an additional loading on churches.

In general, and especially in its earlier years, BSDS has offered credit more cheaply than mainstream banks. In fact, it has consistently offered credit to New Zealand Baptist churches at or below the rates available to residential mortgage borrowers, rates that are already cheaper than mainstream banks typically offer to churches.

Typically, the price of credit offered by banks includes a margin over and above what is required to profitably cover operational costs. This margin is set at a level which seems likely to cover credit losses from defaults. In our opinion, BSDS was able to offer cheaper credit because it arrived at a different credit risk assessment from that of mainstream banks regarding Baptist churches. As the next section shows, BSDS's credit risk assessment was accurate, preventing it from suffering financial loss even as it offered credit at cheaper rates than mainstream banks.

Commercial Viability

A number of factors have made it viable for BSDS to continue to operate commercially, and as a result to mitigate the harmful effects of the structural bias against advancing credit to NZ Baptist churches by the mainstream banking sector. One important factor has been the willingness and ability of BSDS to restructure credit, in almost every instance leading to a profitable outcome without reputational damage.

Lending would not be feasible in BSDS's structure without also attracting a sizeable and committed deposit base at a low cost. This deposit base has historically and is currently largely drawn from the same constituency BSDS lends to: NZ Baptist churches and their members. The evidence we have examined suggests that BSDS's mission, grants and other provision to the Baptist movement, deposit rates, low costs, and specialised risk assessment and management are key factors in ensuring successful commercial outcomes.

Credit restructuring

On several occasions, BSDS has been able to leverage its institutional relationships with borrowing churches and the wider Baptist denomination to restructure existing finance to avoid financial loss or foreclosure.

For example, in June 1968, it became evident that Hamilton Baptist Church was unlikely to be able to repay a short-term loan of $7,000 relating to the Hillcrest project, and an extension was granted until the end of April 1969.[38] In the same month, BSDS agreed to change a short-term loan to a long-term loan for Rimutaka Baptist Church, in response to a letter indicating that they would be unable to meet their final payment.[39] In 1988, a church was granted an extension of the maturity of its loan, initially for six months, and then subsequently for another twelve months. In 1993, a Waikato church was given an additional $13,000 in financing because the church had run a financial deficit. In the 2000s, a church which had borrowed $1.96m from Baptist Savings was able to switch to an interest-free loan when repayments became challenging. And in 2014, another church had its loan changed to interest-only and the maturity date

[38] Appendix E. 4.1.
[39] Appendix E. 4.2.

extended from 2027 to 2071.[40]

This has been possible because BSDS has close connections with the member churches of the Baptist movement in New Zealand, and so is able to negotiate a suitable outcome, in partnership with the denominational leadership. Maurice Cavaney stated that he was "often" able to combine advice and loan restructuring to enable churches to continue to service their debt without foreclosure, partly because of his own close connections with borrowing churches, and also through the networks existing in the NZ Baptist movement.[41] This practice is part of BSDS's ongoing practice:

> Since 2010, only three of our borrowers have got into the position where they have not been able to make payments. In these situations, we immediately make contact with the borrower, progressing to a face to face meeting if problems continue. The board is notified as soon as a loan is technically in default, and is involved in any decision on how to respond. We also engage with the relevant denominational or other applicable leadership groups, and on two occasions in the past 10 years, have funded advisors to assist struggling borrowers.[42]

The BSDS Administration Manual notes that in addition to this policy, "as a matter of course the relevant regional mission leader [a senior leader in the Baptist movement] and the National Leader [of the Baptist movement]" would be involved in any enforcement action around a loan in difficulty.[43]

The Administrator of BSDS pointed out that,

> It is very unusual for borrowers to have trouble meeting their obligations, but when they do Baptist Savings has worked proactively to help them meet their obligations… Because the Baptist Union has an oversight and support role for all Churches, the ex officio Board members from the Union are able to update the Board on any other issues that might be impacting on borrowing Churches. The Union, through its Regional Associations, is able to provide support to any Church experiencing difficulties… These rather unique circumstances have resulted in Baptist Savings only ever having to write off one loan in the 50+ years that it has existed.[44]

This has been to the benefit of both BSDS and the borrowing churches. BSDS has generally been able to avoid the reputational damage and potential financial loss of foreclosing on borrowers, and the borrowers have generally been able to service the restructured loans and repay the capital.

In fact, given that the nominal rate of interest charged has generally been higher than BSDS's funding rate,[45] these restructures not only preserved the financial viability of the borrower, they increased the present value of the loans at the point of restructuring (in other words, the restructure typically benefited BSDS as well as the borrower).

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[40] These last four examples come from an email from Grace Lim, the Administrator of BSDS, dated 27 July 2015 (Appendix C. 2).
[41] Appendix B. 2, paragraph 12.
[42] BSDS *Product Disclosure Statement*.
[43] BSDS *Administration Manual* §1.2.8 (Appendix A).
[44] Email from Grace Lim, the Administrator of BSDS, dated 10 April 2015 (Appendix C. 1).
[45] Except for some restructures involving an interest-free period.

Mission

BSDS has always been clear about its mission of supporting the Baptist movement. At the time Ray French established BSDS in the early 1960s, he was responsible for the financial aspects of the establishment of new Baptist churches under the "church extension programme," and BSDS was set up specifically to enable the progress of this programme.[46] In Maurice Cavaney's opinion, awareness of the mission of BSDS was aided by the fact that in his time, BSDS only lent to Baptist ministries, and this awareness was a key factor in attracting a deposit base from within Baptist churches.[47] Even today, the Administration Manual states that BSDS is, "…a kingdom based ministry that seeks to equip Baptist and other Christian churches and other Christian based ministry organisations… We aim to offer competitive rates and terms, but our real point of difference from the mainstream finance market is that we exclusively serve the kingdom of God."[48] This is also reflected in the structure of BSDS, with an aspiration to have on the Board, "well-networked Baptists, of which one or two are pastors… We should have no more than 4 financial specialists, so our governance contribution does not become unduly about the balance sheet to the detriment of our ministry goals."[49]

Knowledge of BSDS's mission, combined with its offering of deposits at competitive rates (see §4. (b) (iv), "Deposit rates") contributed to BSDS's ability to attract deposits.

Grants and other provision

As mentioned earlier, BSDS administers three funds which provide even cheaper loans than BSDS itself (the Jubilee, Dawnian, and Peninsular funds), administers the Baptist Union's car fund (providing cheap car financing to Baptist ministers), and it also makes grants. For much of the early years of its operation, BSDS offered 3% loans to new churches.

Alongside BSDS in its early years was the "Legion of Donors," another facet of the Baptist church extension programme. While BSDS would provide finance for a new church, the Legion of Donors could be called on up to three times a year to make donations towards the new church, often providing a significant minority of the funding needed to start the new church. The cooperation between BSDS and the Legion of Donors highlights the degree to which BSDS was part of a wider programme of church establishment and development in the New Zealand Baptist movement.

Deposit rates

Because as a matter of policy BSDS has tied the deposit rates it offers to the deposit rates of mainstream banks,[50] depositors are able to place money with BSDS without incurring any interest-rate cost relative to

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[46] Appendix B. 3, paragraph 1.
[47] Appendix B. 2, paragraph 8.
[48] BSDS *Administration Manual*, §1.3.1 (Appendix A).
[49] BSDS *Administration Manual*, §5.1.4 (Appendix A).
[50] "We benchmark ourselves against 6 national banks and set our rates at the average of those 6 banks." (BSDS *Administration Manual,* §1.1.11; see Appendix A). This current policy reflects long-standing practice. Maurice Cavaney surveyed mainstream bank deposit rates on a weekly basis in order to BSDS competitive (although he kept some flexibility in relation to special rates offered by banks), setting the BSDS deposit rate at the average bank deposit rate

depositing money with mainstream banks. They still earn interest at rates no different to those they could obtain through a bank deposit. This means that depositors face no obvious economic disincentive to depositing with BSDS rather than mainstream banks, and in practice makes.[51]

Low costs

Particularly in its earlier decades, BSDS operated with a structure that incurred low costs. As most of the deposits came from the Baptist movement, these deposits were acquired at little or no marketing cost. BSDS also incurred low legal and administrative costs, and only employed a single part-time person for most of its operation.[52]

While BSDS pays depositors broadly similar rates to those offered by the mainstream banking sector, these rates are lower than those demanded by depositors with more comparable specialist lenders. BSDS has a credit rating of B+ and a number of other finance companies also have ratings in the B range, while mainstream banks generally have credit ratings in the A range.[53] BSDS is able to obtain sufficient deposits to operate as a specialist lender, while paying interest rates on those deposits that are comparable to the rates paid by mainstream lenders (with substantially higher credit ratings). The following chart shows the rate comparison.

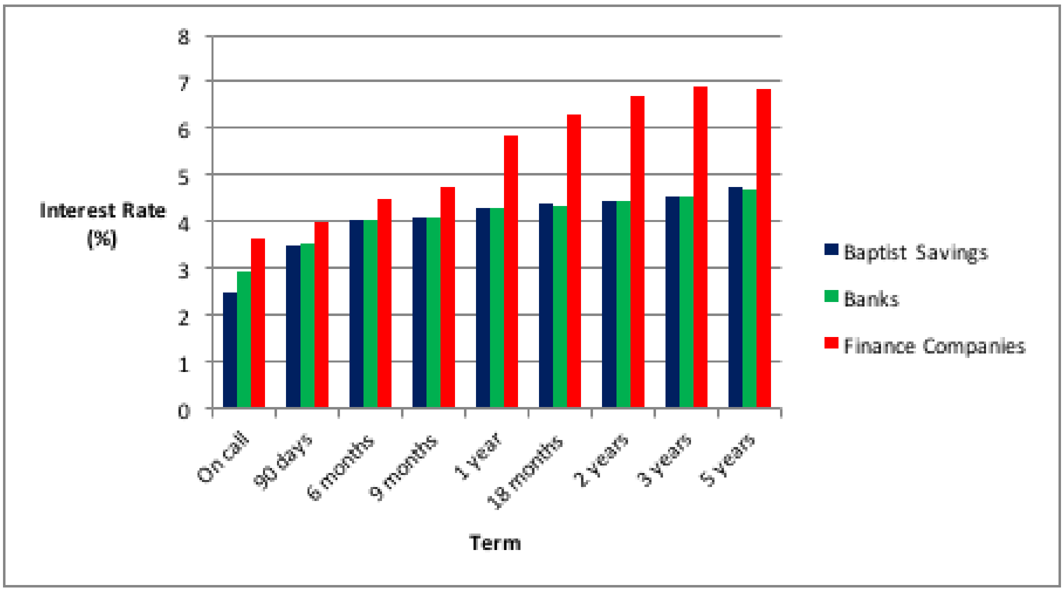

Figure 1: Chart comparing interest rates charged by BSDS, A-rated banks, and B-rated finance companies[54]

(Appendix B. 2, paragraph 3).

[51] In reality this lowers BSDS's funding costs, partly because BSDS's credit rating would suggest that depositors might demand higher interest rates from BSDS than commercial banks, perhaps because of a different assessment of the creditworthiness of BSDS, or a willingness to accept additional risk because of alignment with BSDS's mission. The connection with BSDS's mission is arguably a more conscious choice among those depositors who have made interest-free deposits (see next section). Alastair Maclay believes that awareness of the non-profit status of the society influenced depositors towards accepting lower rates than they might otherwise have done (Appendix B. 1, paragraph 3).

[52] See notes from interview with Maurice Cavaney, Appendix B.1 paragraph 13.

[53] BSDS *Product Disclosure Statement*, 5, 10.

[54] BSDS *Product Disclosure Statement*, 10.

This degree of commitment from depositors[55] shows depositors' willingness to accept additional risk (or, from another point of view, charge less than market rates) in depositing money with BSDS to promote that mission. A consequence of this cheap funding is that it is possible for BSDS to make a (small) profit on excess deposits by lending to mainstream banks.[56]

On top of this, some depositors are willing to make interest-free deposits,[57] and in fact as the BSDS Administrator charges depositors for this service, the deposits are in fact at a negative interest rate and hence contribute to the costs of operating BSDS.[58]

A consequence of being able to fund operations at such low cost was that any excess reserves (deposits and capital not lent to borrowers) could be invested at highly profitable margins. Maurice Cavaney, for example, recalled that at some points in his tenure, when lending at 12% (versus 18% in the mainstream banking sector), he was able to place funds in the money market and earn up to 25%.[59] While this was of course not always possible, even in 1967 (at a point when many loans were being made profitably at 3% or 4%), records show that reserves were being invested at returns of between 4⅛% and 5½%.[60] These returns enhanced operational profitability and were a direct consequence of the cheap funding BSDS was able to obtain.

Specialised risk assessment

BSDS faces the same risk assessment challenges as mainstream banks, but possesses advantages which outweigh those challenges. BSDS staff and board members have close connections with regional Baptist leaders, and often with the people within local NZ Baptist churches. These connections allow them to form accurate judgements about the ability of a particular borrowing church to service a loan.

For example, Alistair Maclay highlighted these links as vital in making credit risk decisions.[61] The approach that has in hindsight been so effective has been a matter of policy since Maurice Cavaney's time in charge.[62] Cavaney also spent time personally investigating the financial status of churches and remained closely involved in their subsequent financial decision-making and financial performance monitoring.[63] He stated that his personal connections through the Baptist movement (where he was active in the Auckland Association and connected with the other regional Associations) gave risk insights at the point of origination. They also gave him access to guarantees from other churches in the Baptist movement, which both spread the financial risk and created relational pressure on the borrowing church to meet their financial obligations.[64]

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55 "We have a reinvestment rate of over 90% with our depositors as at the date of this PDS." (BSDS *Product Disclosure Statement*, 13.)

56 BSDS *Product Disclosure Statement*, 16.

57 Appendix E. 3.5, and Appendix F. 1.4.

58 BSDS *Administration Manual*, §1.1.10 (Appendix A).

59 See notes from interview with Maurice Cavaney, Appendix B. 2 paragraph 1.

60 BSDS Board Minutes, 19 September 1967 (Appendix E. 3.3).

61 Appendix B. 1, paragraph 1.

62 Appendix B. 2, paragraph 6.

63 Appendix B. 2, paragraph 10.

64 Appendix B. 2, paragraphs 11–12.

Of course, the perception within BSDS that they possess this advantageous expertise is one thing; actually demonstrating it is another. The track record of BSDS, with an exceptionally low default rate, suggests that this competitive advantage around risk assessment is real. By reducing the risk of default to a very low (if not entirely quantifiable) level, BSDS is free to operate on a similar spread between deposit and lending interest rates as a mainstream bank does for residential lending.

CONCLUSIONS

Particularly in the early years of operation by BSDS, and to a lesser extent in more recent years, there has been a structural bias against New Zealand Baptist churches in the New Zealand financial system. This has been observed in the reluctance of mainstream banks to advance credit to Baptist churches, and (where credit has been advanced) in the price of the credit offered to Baptist churches.

This structural bias has existed, not because of malign intent against Baptist churches, but because of the *a priori* difficulty of assessing and appropriately pricing the risk of lending to a Baptist church. Some of this difficulty is intrinsic to the organisational and legal structure of Baptist churches, in particular the vesting of property in the Baptist Union. Some of the difficulty is less specific to Baptist churches, such as the reputational risk in case of foreclosure or difficulty of predicting any church's income stream.

BSDS has played an important role in reducing the harm caused by this structural failure in the New Zealand financial services market, by using specialised risk assessment (which has in hindsight turned out to be more accurate than that of mainstream banks), as well as a carefully crafted operational structure, to offer credit to a wide range of Baptist churches at discounted interest rates. BSDS has been able to do this while remaining commercially viable.

While some aspects of the New Zealand financial market have adjusted, in that at least anecdotally it is now easier for Baptist churches to obtain credit from mainstream banks, other aspects remain in place. Notable examples are the vesting of Baptist church property with the Baptist Union, and the institutional relationships which allow accurate credit risk assessment. BSDS is, in our opinion, likely to play an important role in the future in providing specialist financial services which continue to remedy a systematic banking system bias against New Zealand Baptist churches.