

2009 OPPORTUNITY FINANCE NETWORK CONFERENCE

**THE NEW NORMAL**

**Working Capital Financing for Nonprofit Organizations**

Kate Barr  
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Nonprofits Assistance Fund  
October 28, 2009

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**Agenda topics**

Overview of nonprofit financial issues  
Characteristics of nonprofit working capital  
Underwriting working capital loans to nonprofits  
Working capital financing programs for nonprofits

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**What makes nonprofits different from business?**

Mission focus  
Ownership  
Governance structure  
Relationship between income and "market"  
Accounting rules  
Accountability

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### What are the appropriate uses of working capital?

- Improve program and community impact by providing stable source of cash flow
- Finance operating cycle
- Finance seasonal/periodic program needs
- Provide capital for programmatic opportunities
- Provide permanent capital to build or replenish net assets

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### What are the sources of working capital?

Nonprofits have limited sources of working capital

- Accumulated surplus
- Grants or gifts to build reserves
- Vendors/creditors
- Using restricted funds
- Loans

Alternatives

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### Role of basic underwriting

- Cash flow:** ability to repay with adequate unrestricted cash flow
- Capacity:** organizational structure, management, systems
- Character:** executive director and board of directors
- Credit:** have past obligations been honored?
- Capital:** net assets available for contingencies and investment
- Collateral:** secondary sources of repayment
- Community impact:** what are the social benefits?

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**Rule #1: Understand the characteristics of income**

Not all income is the same  
or  
\$1 income ≠ \$1 income

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**Nonprofit income sources: contributed support**

**Grants**

- Unrestricted (general operating)
- Temporarily Restricted (program or time specific)
- Permanently Restricted (endowment)

**Individual donors**

**Special events**

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**Nonprofit income sources: earned revenue**

**Government contracts**

- Cost-based reimbursement
- Per diem, per case, other mandated calculation

**Memberships, tickets, admissions**

**Market-based fees or pricing**

**Developer fees and property management fees**

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### Income mix reflects field of service

- Social services
- Health care
- Child care
- Arts and culture
- Charter schools
- Community/housing development
- Advocacy and policy development

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### Relationship to market

Business ↔ Customer (buyer)  
*Direct value exchange*

Nonprofit ↔ Customer (buyer)  
Nonprofit ↔ Individual donor  
*Different drivers and goals*

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### The Muted Market

Business ↔ Customer (buyer)  
*Direct value exchange*

Nonprofit ↔ Customer (buyer)  
Nonprofit ↔ Individual donor  
Nonprofit ↔ Foundation  
Nonprofit ↔ Government agency  
Nonprofit ↔ Client (service recipient)  
*Different drivers and goals*

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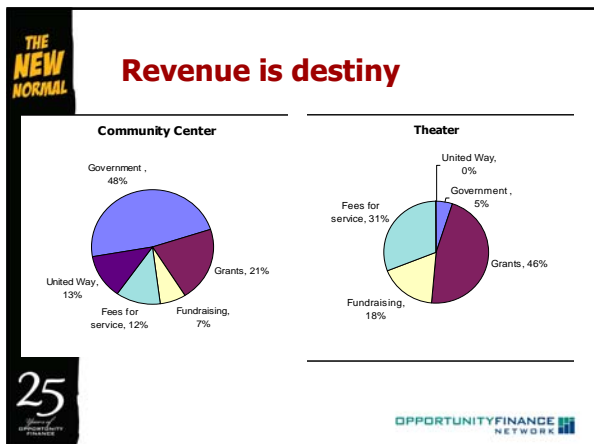
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## Rule #2: Understand nonprofit accounting

**Nonprofits use FASB accrual accounting**

**FASB issues specific to nonprofits**

- Treatment of contributions based on donor restrictions
- Endowments
- In-kind gifts, including discounted services and financing

**Terminology: Net Assets = Equity**

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## Contribution categories

**Contribution categories**

- Unrestricted
- Temporarily Restricted
- Permanently Restricted

**Unrestricted contributions**

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## Temporarily Restricted

**Contributions received with restrictions that expire over a defined time period or by performing defined activities**

Recognized as income when committed

Temporarily restricted funds are "released from restrictions" by the nonprofit when the requirement has been met

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## Permanently Restricted

**Contributions made with the restriction that the principal not be used**

Income/appreciation from the principal can be used for general or specific purposes

Usually an endowment or scholarship fund

Invested and subject to market gains and losses

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## Income Statement

	Unrestricted	Temporarily Restricted	Total
Gifts	\$100,000		\$100,000
Grants	200,000	100,000	300,000
Release from Restrictions	50,000	(50,000)	0
<b>Total Support</b>	<b>\$350,000</b>	<b>\$0,000</b>	<b>\$400,000</b>
Program Expense	280,000		280,000
Mgmt & Admin	60,000		60,000
<b>Total Expenses</b>	<b>\$340,000</b>	<b>0</b>	<b>\$340,000</b>
<b>Change in Net Assets</b>	<b>\$10,000</b>	<b>\$50,000</b>	<b>\$60,000</b>

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## Complex financial info

- In-kind contributions
- Pass-through funds
- Affiliated organizations
- Multi-year funding
- Capital campaigns
- Real estate development

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## Nonprofit Balance Sheets

**Assets**  
 Commonly concentrated in cash and receivables  
 Large investments in fixed assets  
 Investments are often restricted

**Liabilities**  
 Common to avoid debt and leverage  
 Debt is usually for buildings

**Net Assets (Equity)**  
 Classified by restriction  
 May identify board designations

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## Nonprofit Balance Sheet

Cash	\$70,000
Acct. Receivable	40,000
Grants Receivable	15,000
Net Fixed Assets	35,000
<b>Total Assets</b>	<b>\$160,000</b>
Loan payable	\$25,000
Payables	27,000
Accruals	5,000
<b>Total Liabilities</b>	<b>\$57,000</b>
Unrestricted Net Assets	\$63,000
Temp. Restricted Net Assets	40,000
<b>Total Net Assets</b>	<b>103,000</b>
<b>Liabilities and Net Assets</b>	<b>\$160,000</b>

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### Rule #3: Understand working capital sources and uses

**Balance sheet analysis**

- Composition of assets
- Availability of cash
- Sources of debt/credit
- Net Assets

**Changes from period to period**

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### Nonprofit working capital examples

**Social service organization**  
Receivables from government contracts

**Advocacy and policy organization**  
Grants committed and anticipated

**Charter school**  
Single source of revenue

**Housing developer**  
Operating and development activities

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### Challenges to managing working capital

**Lack of control over billing and collection**

**Lack of control over timing of contributed funds**

**Pricing of services**

**Very long business cycle**

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## Rule #4: Understand cash flow

**How to determine the working capital needs?**

- Well developed budget
- Detailed cash flow projections
- Training nonprofit to plan for cash and update cash flow projections

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## Rule #5: Understand management capacity

**Nonprofits don't have private "owners"**

**Rely on combination of executive director, finance staff, board of directors**

**What management is needed to make the operating cycle work?**

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## Business excellence

<p><b>Service delivery business</b></p> <ul style="list-style-type: none"><li>Program development and structure</li><li>Recruit, retain, and develop staff</li><li>Evaluate effectiveness and results</li><li>Respond to changing needs and demands</li></ul>
<p><b>Revenue generating business</b></p> <ul style="list-style-type: none"><li>Provide value to buyers of service</li><li>Maintain reputation and relationships with donors</li><li>Manage events</li><li>Maintain relationships with foundations</li><li>Demonstrate results or outcomes</li><li>Seek new funding opportunities</li><li>Comply with detailed reporting requirements</li></ul>

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**Rule #6: Understand the collateral**

**Nonprofit receivables**

- Grants
- Pledges
- Government contract payments
- Discounted accounts receivables
- Market rate receivables

**Equipment and furniture**

**Real estate – senior/junior liens**

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**Nonprofits Assistance Fund experience**

**Lending to nonprofits since 1981**

**Portfolio size and composition**

**Working capital loan volume**

**Historical losses: 1%**

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**Nonprofit working capital loan products**

**Bridge loan to committed grant/receivable**

**Short term loan (<12 mo.) for cash flow**

- Single payment
- Regular monthly payment
- Irregular payment schedule
- Balloon payment

**Line of credit**

**Long term "investment" working capital**

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## Operational issues: your organization's capacity

**Sufficient infrastructure**  
Employee expertise and capacity  
Time to provide TA and maintain relationship  
Flexible loan servicing system/software

**Checks and balances**  
Clear authority and internal controls are in place

**Adequate loan capital**

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## Operational issues: borrower's capacity

**Knowledge and skills of director and staff**

**System for revenue creation – earned/contributed**

**Accurate accounting system**

**Cash flow management capacity**

**Buy-in of board of directors**

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## Operational considerations

**Loan volume**  
Time required to evaluate, underwrite, document, and service

**Loan size**

**Ability to respond quickly to applications**

**Loan servicing system**  
Flexibility in terms and structures  
Diligent servicing process and procedures

**Technical assistance capacity or referral**

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## Loan structuring

**Terms**  
 Bridge loan to specific payment source  
 Regular payments  
 Irregular payments

**Lines of credit**  
 Maximum line of credit amount  
 Requirements for advances  
 Projected pay down source and timing  
 Track repayment plans

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## Loan structuring

**Documentation**  
 Standard loan documentation  
 Nonprofit organizational documents  
 Board authorization and board role in loan

**Financial covenants**

**Management covenants**

**Required reporting**

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## Collateral

**Primary source: first lien on receivables, pledges, and contract payments**

**Secondary source: general business assets, equipment, fixed and junior liens on real estate**

**Guarantees: will you require guarantees? From who?**

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## Monitoring

- Respond quickly to delinquent payments**
- Review financial reports and provide feedback**
- Willingness to change or extend terms**
- Maintain relationships with key people – director, board chair or treasurer**

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## Staffing

- Job roles and responsibilities**
- Production and business development**
- Skills required**
- Staff development and coaching**

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## Underwriting advice

- Combine analysis and management assessment**
  - Trends analysis and ratios in context
  - Factor for restricted/unrestricted funding
- Business model and funding source don't always match**
  - Revenue and costs don't match
  - Identify the source of subsidy funds
- External factors tend to be complex**
  - Increase in demand doesn't result in increased revenue

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## Risk factors

- Nonprofit management practices
- Organizational turmoil
- External environment
- Collateral
- Fraud

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## Lessons learned

**Nonprofit structure**  
One strong director doesn't make a solid nonprofit  
Meet at least one or two board members

**Relying on uncertain information**  
Compare budget information with similar organizations  
Understand profiles by field of service

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## Lessons learned

**Bridging a gap**  
Committed grants are gobbled up with intervening losses

**"Easy" money**  
Lending too much vs. forcing discipline

**The importance of loan servicing**  
Insist on accountability to terms

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**Impact**

**Stabilize nonprofit operations and their ability to deliver services**  
 Track number of clients served  
 Client demographics

**Improve financial health**  
 Self-reported improvements  
 Annual update of financial indicators

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**Financial tools**

[www.NonprofitsAssistanceFund.org](http://www.NonprofitsAssistanceFund.org)

Cash flow projections  
 Recession risk assessment  
 Scenario planning guide  
 Articles and templates  
 Webinars

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