FISCAL STRENGTH FOR NONPROFITS

Capital Ideas: Savvy Nonprofits Find New Ways to Finance Their Programs

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Financial sustainability is the key to any organization's long-term stability and ability to serve its constituents. While nonprofit leaders are acutely aware of this, many struggle with how to achieve sustainability even as funding sources cut back or disappear. Revenue diversification through earned income can be an attractive answer and a useful financial risk mitigation strategy for nonprofits, making up for some of the gaps created by government contract cutbacks or shrinking donor pools.

However, not all income diversification strategies are right, or even possible, for every organization. It is important that these strategies derive from an organization's underlying asset base. For some this could mean engaging in the classic nonprofit strategy of establishing an endowment that generates investment income to be used in support of operations, while other organizations may be better served by using their unique expertise to generate revenue in a new way. In other words, a wide variety of assets can be "monetized" if you use what you have or what you know strategically and creatively.

Building a Revenue Stream

In June 2007, Modesto Valle was deep in the planning stages for a lesbian, gay, bisexual, transgender, queer (LGBTQ) community center on the north side of Chicago. The building would be a new permanent home for his organization, Center on Halsted, and the base for providing a range of services to its clients. Housing the Center's services to seniors, mental health counseling, a culinary workforce development initiative, plus a range of other programs and administrative offices, the edifice would help the Center meet its commitment to developing and strengthening the local LGBTQ community.

The new building also would present some financial challenges. Together with the board, Valle had several in-depth planning conversations about ways that the organization could remain financially sustainable and still meet the new operating and maintenance costs of a $15 million facility. Five years later, Center on Halsted is thriving, in large part because of a strategic choice to take advantage of its most valuable asset—the building—to generate earned revenue. The Center's strategy includes a lucrative long-term (99-year) lease of part of its facility to a Whole Foods supermarket, as well as rentals of space for meetings and events. Income generated from the building accounts for around 10 percent of the organization's total revenue.

How did Center on Halsted do it? While not every nonprofit has a large, state-of-the-art facility that Whole Foods would like to rent, Valle and his team vetted their earned revenue generating strategy using three principles likely to benefit any organization considering such a plan:

- *Evaluate the activity's fit with the organization's business model.* Consider which of the nonprofit's assets (physical, intellectual, programmatic) are uniquely valuable or marketable, can be put to use in new and creative ways, and are not currently used at full capacity.
- *Analyze the full financial impact of the activity.* Evaluate the total cost, as well as the anticipated benefits, of a proposed earned income program or product. This is important whether the activity will use a portion of current resources or new staff or other assets will need to be obtained to deliver the product or service.
- *Consider the activity's mission alignment and fit with existing programs.* In some cases an organization may be able to monetize an existing program that allows the nonprofit to advance its mission, while delivering strong financial performance—the best of both worlds. But an income-earning activity doesn't necessarily have to directly further an organization's mission (as long as it doesn't detract from it); that revenue still can subsidize activities central to meeting overall objectives.[1]

Center on Halsted used the three principles above to develop an effective earned revenue stream:

Business Model Fit

When considering how to cover the increased operating and maintenance cost of its new building, the Center decided to incorporate retail space into the design to use the well-located modern facility to generate rental income. The team originally had pictured a coffee shop or a bookstore, but Whole Foods was looking to enter the market and heard about the Center's proposed new home. That changed the equation, and after the planners had the deal examined by several attorneys, they were able to reconfigure the space to incorporate the grocery store.

Financial Impact

While Whole Foods potentially was a great fit for Center on Halsted's financial model, the increased operating costs of such a large facility often can lead organizations into a cash squeeze. The Center was able to address this challenge by negotiating as part of the lease agreement Whole Foods' prepayment of the first 25 years of rent.

In addition to its relationship with Whole Foods, the Center is monetizing the building to its fullest, Valle says: "We rent out our theater for events; companies use our conference rooms for retreats; we house a rotating gallery in our common space; we offer community fee-for-service computer classes and gym memberships with league sports nearly every night of the week."

Mission Alignment

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[1] Note, however, that the sale of goods or services may be subject to Unrelated Business Income Tax (UBIT) if carried on as a business not substantially related to an organization's exempt purpose. "Passive" income such as rents and royalties are generally exempt from UBIT.

On the surface, there are few similarities between the missions of a LGBTQ community center and a natural-foods supermarket. The two organizations, however, have certain synergies that added to Whole Foods' appeal to the Center as a business partner. "Right from the beginning, it was a win-win relationship," Valle remembers. "We view our relationship with Whole Foods as a true partnership. We both practice fair and equal opportunity hiring practices and we both understand that we are each running a business." The association with the Center often benefits Whole Foods' business as well; for example, the nonprofit recently hosted a convention for over 2,000 participants, driving lots of lunchtime demand (and revenue) to its neighbor.

Generating New Revenue from Existing Programs

For many nonprofits, tapping real estate to generate new revenues that support their work simply isn't an option. But one "asset" that nearly every nonprofit has is the knowledge, expertise, and practice necessary to deliver services to its clients and constituents. Developing ways of marketing an organization's services to additional customers can be an important way to supplement its revenue base.

Building innovative revenue models is now fully integrated into Michelle Morrison's planning process at Youth Guidance, a nonprofit that creates school-based programs for at-risk children. In 2002, as program director, she undertook a new fee-for-service initiative at the South Loop Elementary School in Chicago. South Loop approached Youth Guidance about implementing its after-school program for students on a tuition basis, and for the first time in the organization's history, Youth Guidance charged parents directly for its programs, using its expertise to improve the bottom line.

The new program ended up not only covering its expenses, but also generating additional revenue for Youth Guidance. "Initially moving to a fee-for-service model was not intentional, but has turned into a jumping-off point for the organization," says Morrison, who is now the Executive Director. "We are in such a different place now, we have built our internal capacity to provide fee-for-service programs and are looking to expand this model in a deliberate way."

In the process, Youth Guidance faced some challenges in developing its earned income venture into the fully integrated facet of the organization's operations that it is today. The new program model initially created tension in the nonprofit, as some staff members struggled with the idea of serving a new mixed-income demographic, rather than its traditional focus on lower-income communities. "We had to help the staff understand how this new way of doing business fit into the current model," says Morrison.

In addition to resolving the new program's effect on the organization's mission, Youth Guidance also had to address questions about the venture's business model and financial impact. Partnering with the right school was key to creating a viable strategy, and the fact that South Loop had approached Youth Guidance demonstrated that the demand was there to support such a program. Moreover, parents and school leaders at South Loop were highly engaged and supportive of Youth Guidance's involvement, and the program's success and good word-of-mouth led to referrals to four other local schools.

Another central question in establishing a fee-for-service model is determining how to price the service. At a minimum, the amount should be enough to cover the costs of delivery. That means the organization must understand the expenses—direct as well as indirect—associated with providing the program. Once this break-even minimum is established, a market analysis can help to determine whether it is possible to generate sufficient revenue to operate a financially sustainable service—ideally one that generates surpluses to fund other organizational needs. Youth Guidance worked through each of these questions as part of introducing its program, developing an expense projection that analyzed anticipated costs, as well as investigating comparable programs and surveying interested parents to get a sense of pricing parameters. Ultimately, Youth Guidance, parents and school leaders collaborated to establish a sliding scale tuition that established a financially sustainable program, while ensuring all interested families were able to participate.

These lessons have helped Youth Guidance solidify and grow its fee-for-service model. Today, further expansion is on the horizon. Together with her staff, Morrison is working to put systems in place, such as evaluation metrics and standardized pricing, to support this growth. Youth Guidance is on its way to building an effective earned revenue program that draws on organizational assets, provides a financial benefit, and supports its mission.

Conclusion

For many organizations, exploring alternative revenue streams and earned income can be a significant strategy for surviving and thriving in today's financial environment. Whether they are capitalizing on a specific program's success or renting out a facility, finding new ways to generate unrestricted revenue is essential to long-term sustainability.

These strategies, however, are not without their challenges. In addition to using the three principles of fit—business model, financial impact and mission—to evaluate earned revenue approaches, organizations also should consider opportunity costs involved in launching an earned revenue project and maintaining it over time.

In the cases of Center on Halsted and Youth Guidance, both organizations have been affected by the economic downturn that has challenged nonprofits in Illinois and across the country. However, because the leaders of these organizations took strategic steps to build a diversified revenue base, including a solid earned income component, they have been able to weather the financial challenges better than many of their peers. As Valle and Morrison look ahead, they see new earned revenue opportunities on the horizon, and are working to focus on those strategies that will support both their missions and the bottom line.