CASE STUDY: APPRECIATING DEPRECIATION
Thinking Strategically About Fixed Assets

BOSTON CENTER FOR THE ARTS

Boston Center for the Arts

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Nonprofits that own or operate historic facilities often struggle to cover the high costs of maintenance and repair of these properties, and many do not adequately "fund" depreciation. While in the short-run it can be tempting to defer maintenance and investing in renovations, organizations eventually find that these decisions negatively impact their ability to provide high caliber, on-site programs. While running a periodic capital campaign is one strategy, articulating the case for repair to funders can be difficult and campaigns can exhaust staff and volunteers.

The Boston Center for the Arts (BCA) is a prime example of an organization facing such challenges. Starting in 2005, Nonprofit Finance Fund (NFF) engaged with the BCA at a time when it was energized by a fresh vision that included a commitment to new programs and ventures. This new plan did not, however, clearly express how the BCA would care for its 170,000 square feet of property. NFF completed a financial analysis of the BCA and helped leadership quantify its facility needs, identifying nearly $3 million in deferred maintenance and program-critical renovation. This case study tells the story of how the BCA developed a new financial model and operations plan to secure its future.

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With Assets Like These, Who Needs Liabilities?

In the late 1960s, the Boston Redevelopment Authority purchased a parcel of land and historic buildings in the South End to create an arts center to support the city's visual and performing artists and encourage community engagement with the arts. The aptly-named Boston Center for the Arts became a home for artists, a destination for audiences, and a bridge between the arts and the city's diverse communities. Today the agency operates a sprawling artistic campus consisting of five buildings, including significant event space, below-market studios for visual and performing artists, space for established organizations such as the Boston Ballet, a contemporary art gallery, theaters, and two popular dining establishments.

Throughout its history, the BCA has struggled to balance its identity as a landlord for artists and nonprofits with its mission to provide meaningful arts programming on the campus. Furthermore, for much of this time the BCA has lacked the expertise to manage a large, complex, and historically significant property.

As part of a concerted effort to evaluate the multiple demands on its resources and understand how the facilities were affecting its financial health, the BCA engaged with Nonprofit Finance Fund (NFF) in 2005. NFF conducted a Nonprofit Business Analysis for the BCA, analyzing five years of its financial statements to help the organization understand the dynamics of its financial model. Building on this work, NFF then performed a Systems Replacement Plan, a process that quantifies the investments the agency should make in its facilities over the next twenty years. Finally, NFF provided the BCA with an Energy Review, identifying opportunities for energy conservation.

Nonprofit Finance Fund's Findings

NFF's analyses revealed that the BCA's operating model at the time was insufficient to support its facilities. The organization was unable to cover depreciation expense each year and had no clear strategy to address the nearly $3 million in deferred maintenance. It was also clear, however, that the organization had significant untapped opportunities. While on average the BCA already covered 60% of its operating expenses through earned income — a ratio that sets it apart from many of its arts peers — the Board and staff knew that the agency was not fully leveraging its physical assets to generate revenue. Both NFF and the BCA agreed that the very assets that were the cause of great financial distress could be they key to its turnaround.

A Plan for the Future

After absorbing the NFF analysis and strategizing internally, the BCA began to address its considerable facilities issues in earnest in 2006. Grants from several foundations enabled the BCA to replace broken and energy inefficient windows in two of its main buildings, the Cyclorama and the Tremont Estates Building. Next, the BCA made critical repairs and improvements to its art gallery and theaters. While this early work signified the BCA's new focus on facilities management, the agency took a major step forward in June 2008 when the Board approved a five-year plan to generate earnings sufficient to pay for $1 million of the nearly $3 million of deferred maintenance.

Acting CEO and President Lisa Giuffre explains: "This plan focuses on generating earned revenue while maintaining our arts programs and services as is." Specifically, the BCA intends to rent more of its spaces for private events, consider short-term property leases, and launch an on-site retail concept, all to achieve the goal of generating operating surpluses of 25-30% each year for the next five years. The surpluses will be combined with a $400,000 award from the Cultural Facilities Fund of the Massachusetts Cultural Council to pay for the first phase of facility improvements.

According to Giuffre, the BCA divided the nearly $3 million of deferred maintenance items into three prioritized "buckets" to give structure and focus to the work ahead. In the first five years, the organization will tackle multiple facility "safety and soundness" projects, including updating the HVAC systems in two of its main buildings. After five years, the BCA will focus on major but less pressing capital renovations. Finally, cosmetic improvements will be made to the grounds and buildings. Separating action items in this way provided a clear roadmap for the BCA staff and Board; without it, the agency may have continued to feel overwhelmed by the volume and cost of its facility projects. To complement the "buckets," Giuffre knows that the agency must also make some investments in the building to specifically generate additional earned income. For example, Giuffre has obtained the Board's approval to use cash reserves to fund smaller projects, such as $120,000 to purchase the lighting and sound equipment that outside organizations normally obtained from a local vendor when they rented the BCA venues. Now, the BCA will charge the renter for this equipment, thus creating a new source of earned revenue while streamlining relationships.

By focusing on stabilizing its facilities and protecting its balance sheet with an eye towards sustainability, the BCA is following Nonprofit Finance Fund's recommendation of "linking money to mission" — drawing a clear line between financial health and the programmatic value created for the community. Of course, as with any nonprofit, the focus cannot be solely on earned income; contributions certainly play a role as well. While the BCA leadership is not looking to fundraise its way through its facility maintenance dilemma in the short-term, there is a plan to initiate a capital campaign in the fifth year to pay for the $2 million remainder of the deferred maintenance. To support this vision, the BCA already has begun cultivating donors and has plans to redesign its membership program to contain more exclusive benefits and graduated levels of involvement.

Fostering Culture that Supports Priorities

Giuffre describes the Board's reaction to the BCA's five-year plan as one of "enthusiasm" and "relief." While the organization knew that it had deferred maintenance and repair over the years, it did not realize how serious the problem was or how it might be solved. Moreover, neither the Board nor the staff knew the extent to which the facilities issues could potentially limit the BCA's ability to fulfill its mission. Once the staff and Board worked together to design the five-year plan to address the facility issues, the BCA was able to move forward with confidence and optimism.

Shortly after the engagement with NFF, the BCA began to make decisions representative of its new outlook on its facility. First, the Board embraced a budgeting model that encompasses the full cost of doing business, which included not just operating expenses but also "funding" depreciation and establishing cash reserves. Cognizant of the importance of setting aside funds to repair and eventually replace fixed assets, the Board and staff advocated for this practice with a passion. Next, the BCA discontinued its use of outside contractors and instead hired two full-time employees who could regularly monitor and maintain the BCA's facilities. Third, the Board established a Real Estate Committee to oversee the health of the buildings and explore potential business opportunities. Finally, the agency invested in administrative tools to track revenue and expenses generated by each building on the campus.

According to Giuffre, "we actually began to view our facilities as a 'program' that required strategic, annual allocations rather than sporadic, reactionary repairs." In this way, the BCA demonstrated that it was committed to investing in and preserving its fixed assets rather than simply treating them as an overhead expense.

In the midst of these changes to the procedures and culture of the BCA, the organization took the opportunity to infuse green practices into its operations. In spring 2008, the BCA began exploring the use of natural gas or solar energy to power its tenant buildings. An investment of this nature would complement the BCA's existing sustainability practices, which included the use of energy-efficient light fixtures and ENERGY STAR-rated appliances in tenant spaces as well as a campus-wide recycling program. BCA management feels strongly that these practices will help staff, visitors, and tenants play an active role in caring for the facilities.

Redirecting Course: Lessons Learned

What organizational decisions allowed the BCA to move from feeling overwhelmed by its Property, Plant & Equipment to tackling years of deferred maintenance? How did the organization use financial information to rally its Board and staff around a common purpose? NFF observes that the BCA story provides three powerful lessons for organizations struggling to take control of their facilities.

1. **Understand the Full Cost of Doing Business.** The BCA's Property, Plant & Equipment represented a major cost of the agency, but most of the expense — several hundred thousand dollars in depreciation expense annually — never showed up on the budget. As a result, the BCA found itself failing to properly fund its facilities in terms of depreciation, repair, and ultimately replacement. Organizations need to work diligently to educate their Board and staff about the full cost of operations so that they can "appreciate depreciation" rather than disregard it.

2. **Link Money to Mission.** The BCA was challenged by its multiple roles as landlord, provider of arts programs, and manager of historic property; its resources were being used for existing and new programs rather than for building maintenance and repair. Once the BCA Board realized that the condition of its facilities could affect the organization's ability to fulfill its mission, it developed a new financial model and operations plan that would help redirect course. Like the BCA, all nonprofits should devote resources to mission and programs while also making sound financial decisions that enable future growth and sustainability.

3. **Foster a Culture Reflective of Facility Needs.** In coming to terms with the central role the property played at BCA, leadership made a number of key changes. These include moving to in-house facilities management, tracking revenue and expenses associated with each building, and incorporating more green practices into the organization. Nonprofits placing new focus on their facilities can follow the BCA's example of treating their buildings as a "program," rallying human and capital resources around an organizational priority.

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