Nonprofit Finance Fund

Youth Servers Facilities Study

PROVIDING FINANCIAL INCENTIVES FOR SOUND BUILDING MANAGEMENT

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NFF's asset-building financial product, Building for the Future[SM] (BFF), originally sprang from a research study NFF conducted with the support of the Charles Hayden Foundation. The study was commissioned to examine ways NFF and the Hayden Foundation could work together to provide financial incentives that would reverse disinvestment in facilities that serve low- and moderate-income youth.

We chose as our subjects eight Boys & Girls Clubs in the New York and Boston areas (out of 35 in the area as a whole). The clubs were all located within the Hayden Foundation's catchment area and represented a spectrum of location, club size, endowment size, usage, and other characteristics.

In collecting data from the clubs, we were interested in information that ultimately would help us design a program to optimize the overall capitalization of the clubs. Acknowledging that the clubs' facilities themselves are a major part of the clubs' asset base, NFF studied the interaction of the building operations with financial (revenues, expenses and other items on the balance sheet such as cash reserves, endowment and debt) and programmatic (levels of use, club membership trends, other building uses and programs) aspects of the clubs.

The Boys & Girls Clubs were chosen because as a group they are building centered, among youth servers they tend to be well-funded and well managed, and because they had received high-quality technical assistance with their buildings over a period of years from the Boys & Girls Clubs of America (BGCA). BGCA had found the same roadblocks to full implementation of sound building management practices as NFF and the Hayden Foundation. In short, while the clubs as a whole were in relatively good shape in relationship to their peers, and they had received standard technical assistance, they still were not fully implementing building management procedures.

For most managers of youth-serving organizations, including those at Boys & Girls Clubs, this pattern of not implementing building management practices persisted despite knowledge that such measures save money and are effective. The problem was, in part, a result of the realities of the funding environment. Clubs and other youth-servers reported that virtually all their funders favored dramatic “rescue” grants for emergencies or “one-time opportunities” while rejecting general operating support or “overhead” that would fund ongoing management improvements. The unintended effect of such policies was to provide an expensive incentive for poor management.

To make a transformative change, we realized we needed to induce a systemic shift, where the cause of disinvestment was identified, and the incentive applied to the correct point in the building cycle.

Summary of Study Findings

Clubhouses are central to the Boys & Girls Clubs' mission. They support the shared identity and culture of the organization and embody its distinctive approach to youth development. They represent permanence, community, and safety for the children they serve. Clubhouses frequently dominate the program and the financial structure of individual clubs.

Our sample included one-quarter of the clubs in the Hayden Foundation's catchment area. Some of the data – particularly with respect to attendance and membership – are inconsistent. Therefore, making strong general conclusions based on the sample is premature. However, we identified some fairly clear patterns.

Buildings, Programs and Finances are Interdependent

Our research confirmed our assumption that the states of health of the program, finances and building are interdependent. We found that the best-attended clubs generally had the highest number of permanent staff, indicating that dedicated leaders (not square footage) attract young people. This mirrors our experience with educational, performing arts and religious organizations, as well as with other youth-servers.

We also observed in financially healthy clubs a relationship, on a per square foot basis, between high levels of staff, usage, and revenue. While our sample was too small to form conclusions, it is possible that permanent staff not only attracts more participants but more grants over time—even though it means higher initial operating expenses.

Clubs with high square footage are more financially fragile if they lack a proportional endowment and revenue. Square footage attracts neither members nor money. Of the four clubs with above-average square footage (average for the sample was 37,000), three are financially fragile. Clubs in the largest buildings also have the highest ratio of square footage to members and the lowest "kid density" (average number of kids/square foot/day). Relatively good financial health, not surprisingly, is linked to higher outlays for the building (capital items, depreciation and occupancy expenses) and relatively low building disinvestment levels. Two of the healthiest clubs financially are also two of the three smallest.

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The point here is not that big is bad, but that big buildings require more cash assets and more revenues, not less. The allocation of assets in the largest clubs appears to have been distorted by the unbalanced growth that occurs when building investment is added to the balance sheet without adequate cash reserves. The effect is that the fixed cost of operations increases (including both building-related and program-related expenses) while overall cash is decreased. The effect is that the building starves the program of cash.

Both inadequate revenues and unrecognized costs fuel building disinvestment

Most of the clubs sampled show a three-year pattern of modest growth in programming, ongoing capital project fundraising, and diversification of services (into day care and on-site school programs). Notwithstanding this program growth, revenue growth in most categories has been modest and operating results flat. Clubs with endowments have prospered with the ascent of the stock market, but revenue directly or indirectly dependent on the existence of the club building has been consistently flat for the last three years for all clubs. A majority of clubs don't fund depreciation (i.e.-set aside cash reserves) of their plants and equipment. Some of the clubs that lack adequate development capacity have turned to their buildings as sources of revenue by leasing space for non-club activities. The results are mixed.

When the facility is fully costed (funded depreciation added to overall expenses) and compared to building-related revenues (program grants, memberships and related revenue) virtually all clubs sampled operate in the red. The clubs with endowments overcome this by strong income from investment and events. Clubs lacking endowment income do so by turning to program diversification and revenue-producing ventures. These, however, do not appear to truly increase net revenues. Clubs in this category then close the gap by stretching staff and underfunding depreciation and preventive maintenance in the building.

Revenue-producing activities are not adequately capitalized or costed

Most clubs sampled lack adequate cash (overall net cash flow and cash reserves) to fund their operations or program growth. This means that when a club tries to generate revenue by more fully using or expanding the building, the cost of undertaking that venture is borne by other parts of the operation. When the club is undercapitalized, the true cost of projects, such as housing or operating a preschool or day care program, housing bingo in the clubs' off-hours, or renting parts of the building to others, may be experienced as overload and diversion of staff, as unfunded capital projects, or as variance from the central mission.

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Groups in our sample that are most reliant on non-club, non-investment sources of income (government contracts, bingo, rentals) have a fairly uniform profile. They have the lowest ratio of full time staff to square footage, the lowest depreciation amounts on their audits (indicating lack of ongoing capital reinvestment as well as older buildings), the lowest spending for occupancy-related costs (including preventive maintenance and replacement reserves) and the lowest participant densities. Clubs with building-driven activities, such as rental income and bingo, which contribute the highest percentage of revenues, spend the least on their buildings per square foot. Endowed clubs with investment income comprising the largest percentage of revenues spend double the average per square foot on their buildings.

Raising large-scale endowments is unrealistic for all clubs, and diversification into pre-school and related programs undoubtedly has positive program return. However, revenue production from more extensive use of the building cannot replace revenues from endowment, fundraising and program. The data we examined indicate that such projects are not adequately scrutinized with respect to their cost. Expansion of facilities or additional programs increases costs as well as revenue, and the costs are fixed. Many clubs that are undertaking such expansions appear to be inadequately costing or capitalizing them.

The level of disinvestment is substantial but manageable in most cases

The majority of clubs surveyed needs to increase their levels of ongoing spending on operations (as well as their revenues) and to strengthen their balance sheets by increasing cash reserves. The lion's share of most clubs' assets is their building. Disinvestment of this capital base has funded their working capital needs. The clubs in question have no "profits" from which to generate working capital.

The clubs need to:

reverse the disinvestment and fund building and equipment replacement reserves

incrementally increase annual spending on preventive maintenance and development capacity

increase net revenues to cover these costs

capitalize overall operations adequately by working to fund operating reserves at the level of 2.5 times annual expenses

While we estimate that the optimal level of investment in the eight clubs over the next 20 years will be substantial, we are also optimistic that this goal is approachable for most. Moreover, any improvement will be positive, since the current capitalization is so strongly tilted toward fixed assets, and the level of deferred maintenance is high throughout the system.

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An ongoing program of system replacement will prove to be much more cost-effective than replacing systems on an as-needed basis when they have already broken down. Fully funding capital needs -- including establishing a building replacement sinking fund for systems and other parts of the building, developing an endowment to a level of two and one-half times annual expenses, and a cash reserve equal to six months annual expenses -- would require at least three times current levels (a range of from two to five) for most clubs in the sample.

Clubs will need to increase ongoing funding of reserves and plan and execute regular capital campaigns to fund both cash and fixed asset needs. Improving development capacity by investing in "human capital" at virtually all clubs is a vitally important complement to investing in replacement reserves.

While this paper focuses on the need for facilities reinvestment, we believe that the solution proposed through BFF's approach has abundant potential to help clubs improve their overall capitalization. The findings make clear that the root cause of the facility problems is undercapitalization of the clubs' core business. Most clubs' balance sheets are heavily tilted toward fixed assets and they lack cash for working capital. Clubs with the highest levels of fixed assets starve their buildings as cash is channeled to other needs.

Moreover, we believe that these challenges are the same for other facilities-reliant nonprofit organizations, such as theaters, schools, community centers, health and child care providers, and faith-based institutions. The Building for the Future℠ asset-building product represents a strategy that has broad applicability to these and other nonprofits, and we see many opportunities for expanding it.

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