

Nonprofit Financial Health Webinar Series

Recent Trends in Nonprofit Balance Sheets and Capital Investment

The Moody's Foundation

National Center for Charitable Statistics at the Urban Institute

Indiana University Lilly Family School of Philanthropy

October 23, 2014



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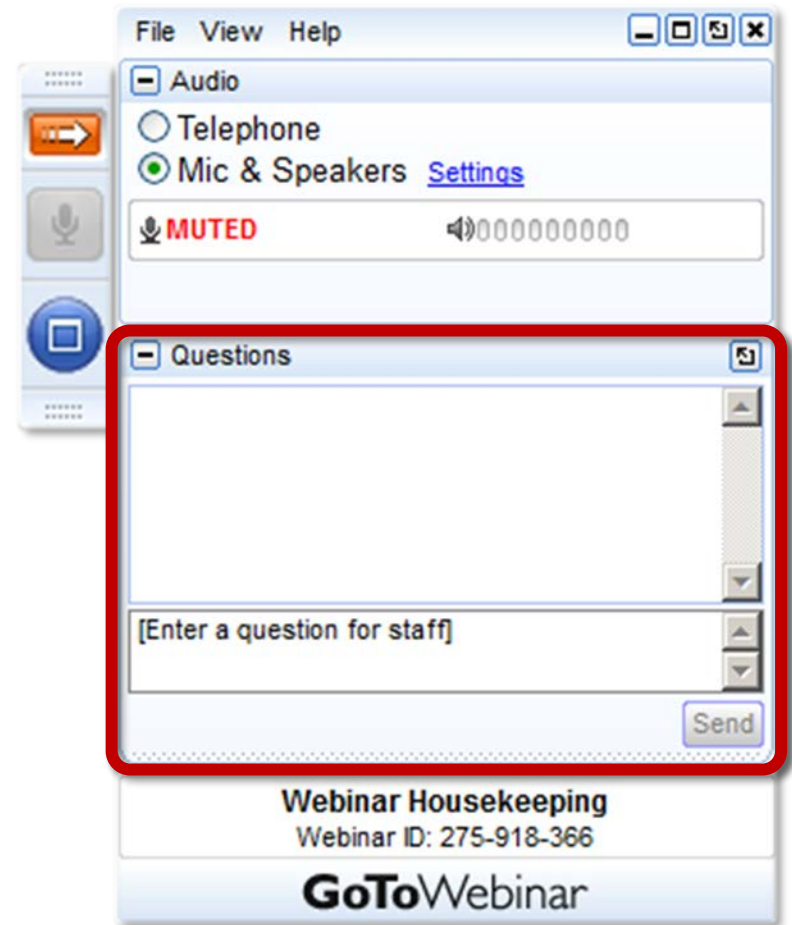
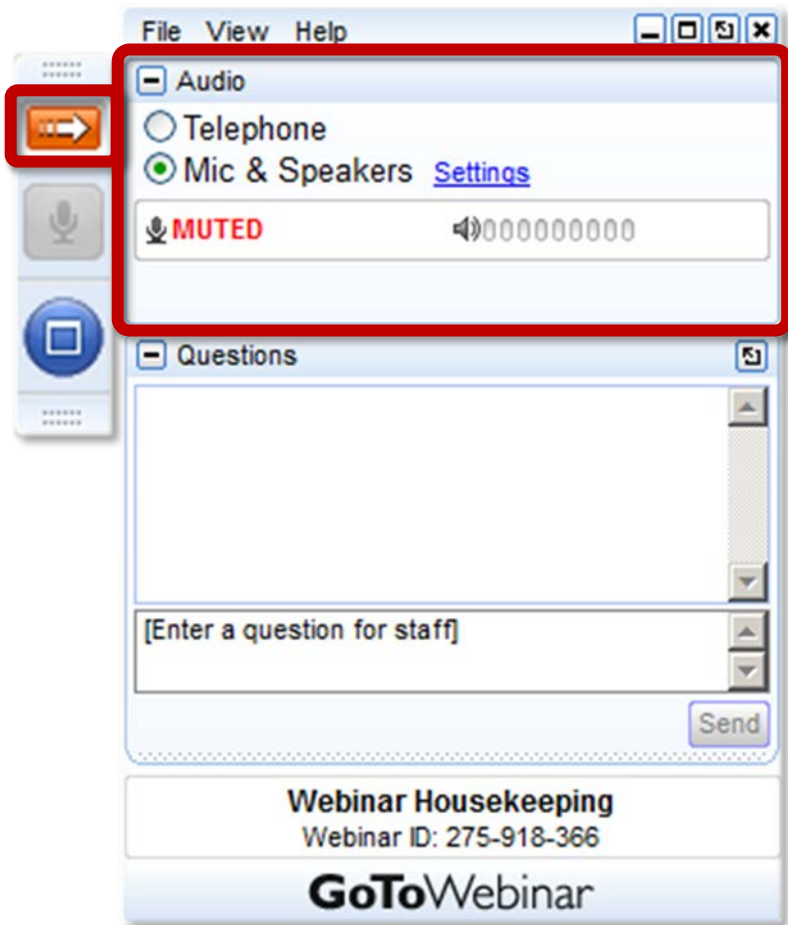
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Today's Webinar

Moderator

- Una Osili

Director of Research, Professor of Economics & Philanthropic Studies,
Indiana University Lilly Family School of Philanthropy

Presenters

- Thomas Pollak

Program Director, National Center for Charitable Statistics at the Urban
Institute

- Dennis Gephardt

Vice President and Senior Analyst, Moody's

Overview

- Use of Debt by Public Charities
- Nonprofit Capital Investment and Management of Balance Sheets
- Questions and Discussion



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Use of Debt by Public Charities

**Recent Trends in Nonprofit Balance Sheets
and Capital Investment**

October 23, 2014

Tom Pollak

**National Center for Charitable Statistics
Center on Nonprofits and Philanthropy
The Urban Institute**



Financial Overview

	2003 (Inflation- Adjusted)	2012	Percent Change
Finances			
Total revenue	1,285	1,587	23.6
Total expenses	1,243	1,502	20.8
Total assets	2,278	2,899	27.2
Total land, buildings & equipment	610	839	37.4
Total liabilities	890	1,178	32.4
Total debt	461	555	20.5
Ratios			
Assets-to-expenses	1.83	1.93	5.3
Land, buildings & equipment-to-expenses	0.49	0.56	13.7
Debt-to-assets	0.20	0.19	-5.3
Debt-to-land, buildings & equipment	0.75	0.66	-12.3

Public Charity Debt, 2012

Type of Debt	Percent of Public Charities	Total (\$ in millions)	Percent of Debt
Tax Exempt Bonds	3	379,707	68
Loans from Officers	3	2,952	1
Secured mortgages and notes payable	22	140,240	25
Unsecured notes and loans payable	6	32,487	6
Overall	29	555,386	100

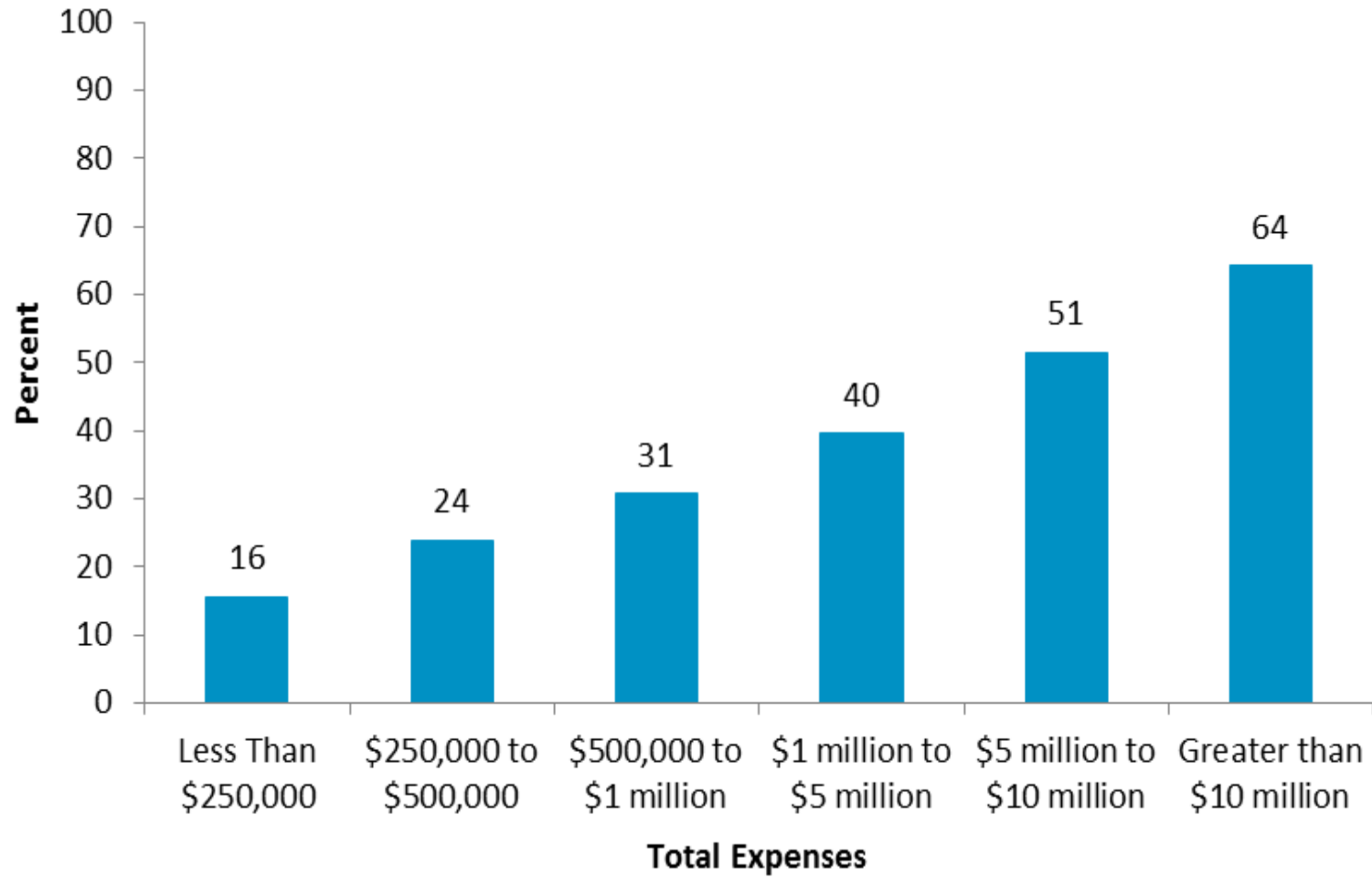
Source: National Center for Charitable Statistics, Core 2012 Public Charity Full 990 File

Organizational Characteristics Associated with Debt Use

	Debt Use
Organization size	+
Type of Organization	
Arts	
Higher Education	+
Other Education	+
Environment & Animals	-
Hospitals	+
Other Health	+
Human Service-Capital Intensive	+
Human Service-Labor	+
International	
Age	+
Reliance on Program Service Revenue	+
Fixed Assets Ratio	+

Source: National Center for Charitable Statistics, Core 2012 Public Charity Full 990 File

Percent of Public Charities Reporting Debt by Organization Size, 2012



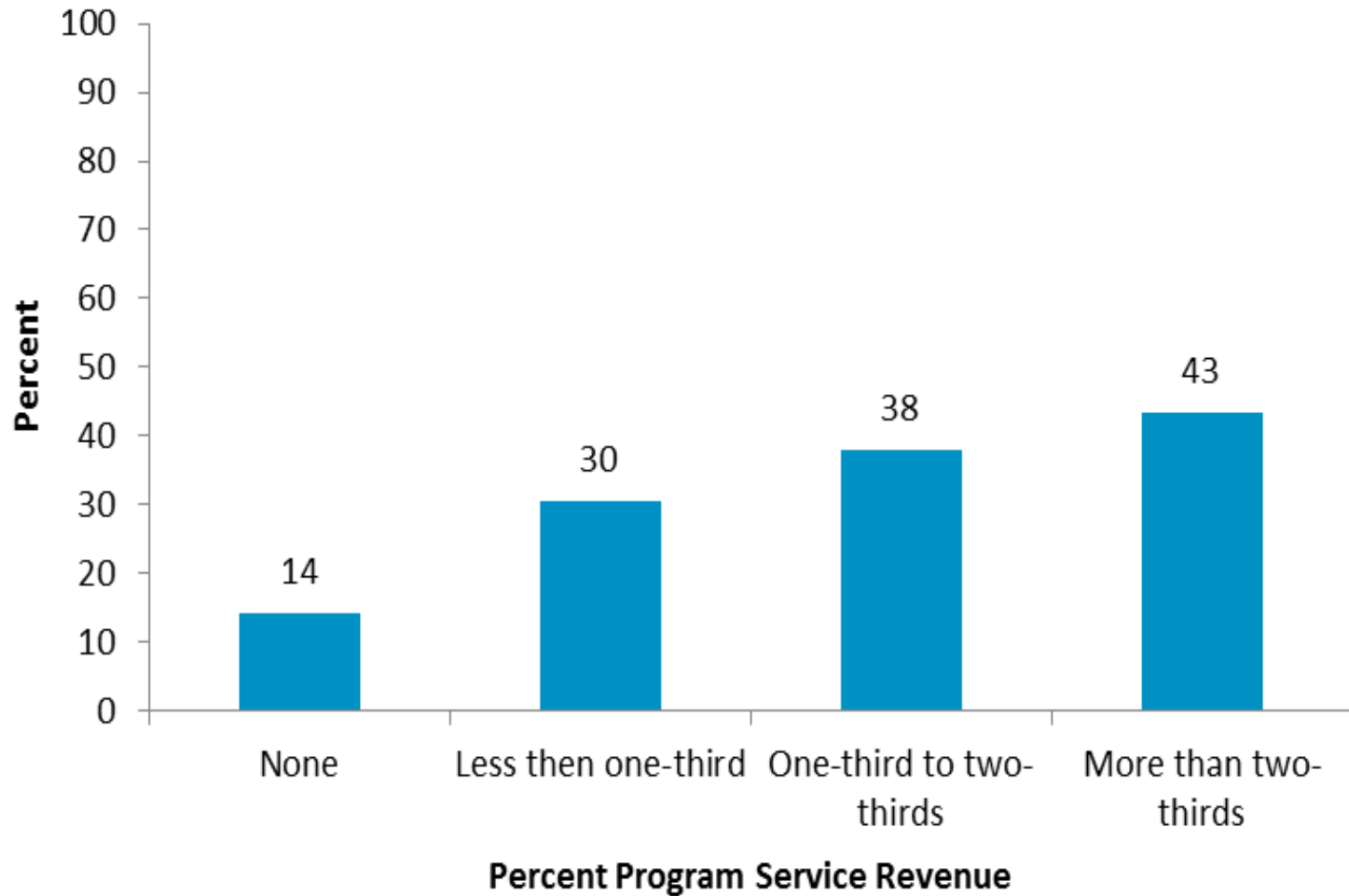
Source: National Center for Charitable Statistics, Core 2012 Public Charity Full 990 File

Percent of Public Charities Reporting Debt by Type of Organization, 2012

Type of Organization	Debt Use (%)
Arts	25
All Education	27
Higher Education	70
Education Other	24
Environment	20
All Health	31
Hospitals	59
Health Care Other	28
Human Services-Labor	32
Human Services-Capital	57
International	14

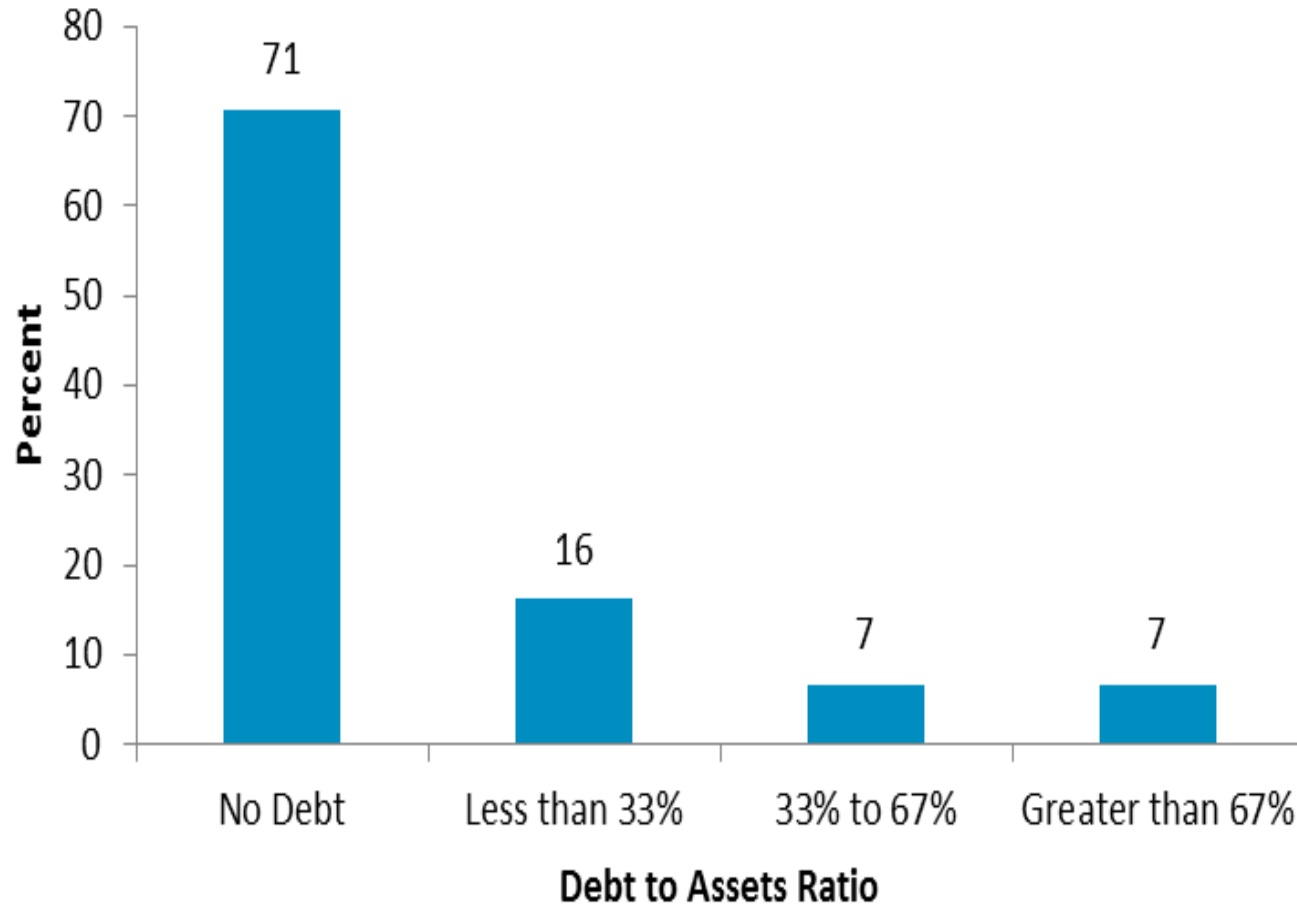
Source: National Center for Charitable Statistics, Core 2012 Public Charity Full 990 File

Percent of Public Charities Reporting Debt by Reliance on Program Service Revenue, 2012



Source: National Center for Charitable Statistics, Core 2012 Public Charity Full 990 File

Distribution of Public Charities by Debt to Assets Ratios, 2012



Source: National Center for Charitable Statistics, Core 2012 Public Charity Full 990 File

Percent of Assets Financed with Debt by Organization Size, 2012

Organization Size (Total Expenses)	Overall Debt to Assets Ratio (%)	Average Debt to Assets Ratio (%)
Less Than \$250,000	12	8
\$250,000 to \$500,000	16	11
\$500,000 to \$1 million	17	13
\$1 million to \$5 million	16	14
\$5 million to \$10 million	18	16
Greater than \$10 million	20	18

Source: National Center for Charitable Statistics, Core 2012 Public Charity Full 990 File

Percent of Assets Financed with Debt by Type of Organization, 2012

Type of Organization	Overall Debt to Assets Ratio (%)	Average Debt to Assets Ratio (%)
Arts	11	8
All Education	16	10
Higher Education	17	19
Education Other	14	10
Environment	6	6
All Health	21	10
Hospitals	24	17
Health Care Other	11	9
Human Services-Labor	22	11
Human Services-Capital	50	36
International	6	5

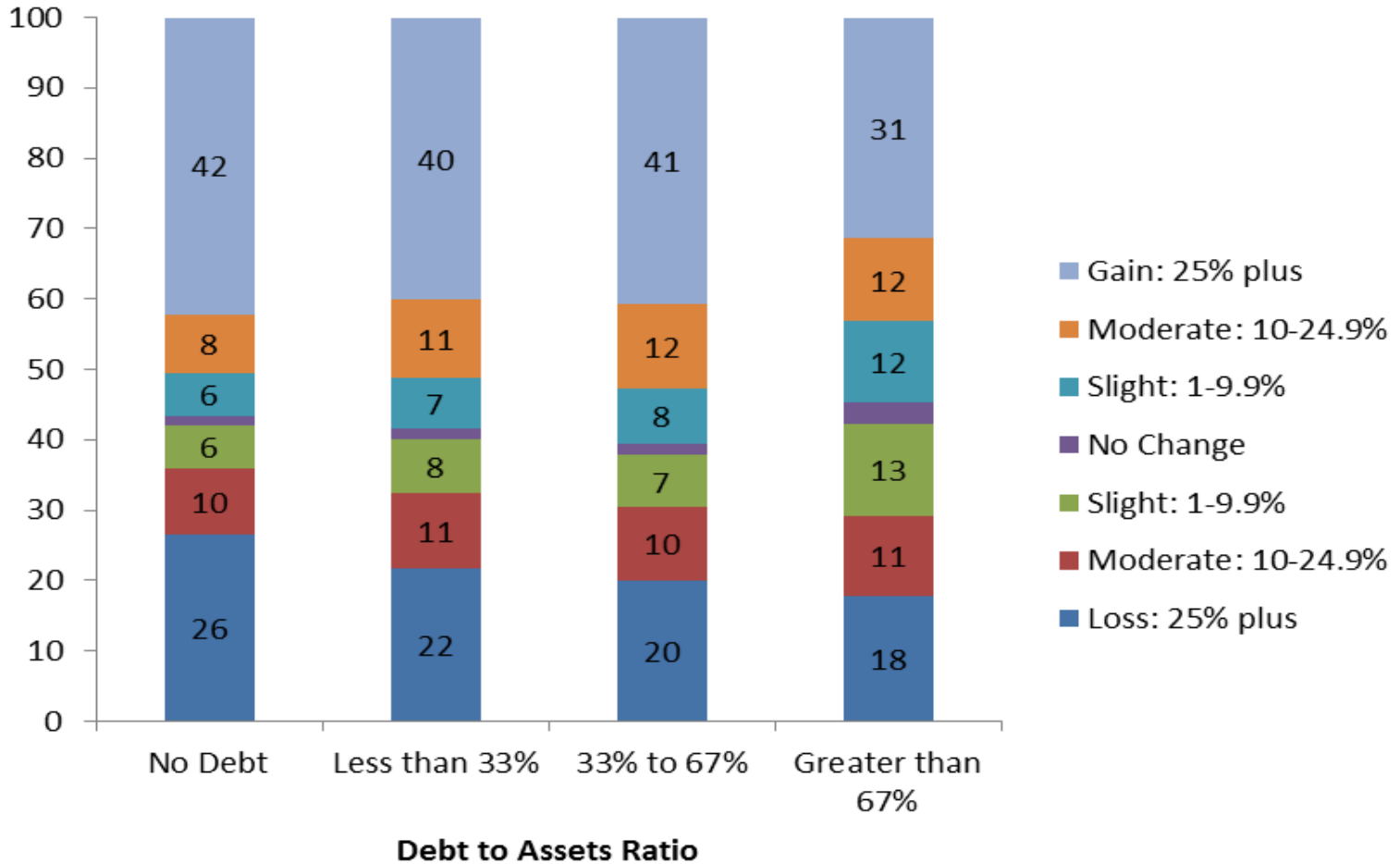
Source: National Center for Charitable Statistics, Core 2012 Public Charity Full 990 File

Percent of Assets Financed with Debt by Reliance on Program Service Revenue, 2012

Percent program service revenue	Overall Debt to Assets Ratio (%)	Average Debt to Assets Ratio (%)
None	5	5
Less than one-third	9	10
One-third to two-thirds	17	14
More than two-thirds	26	19

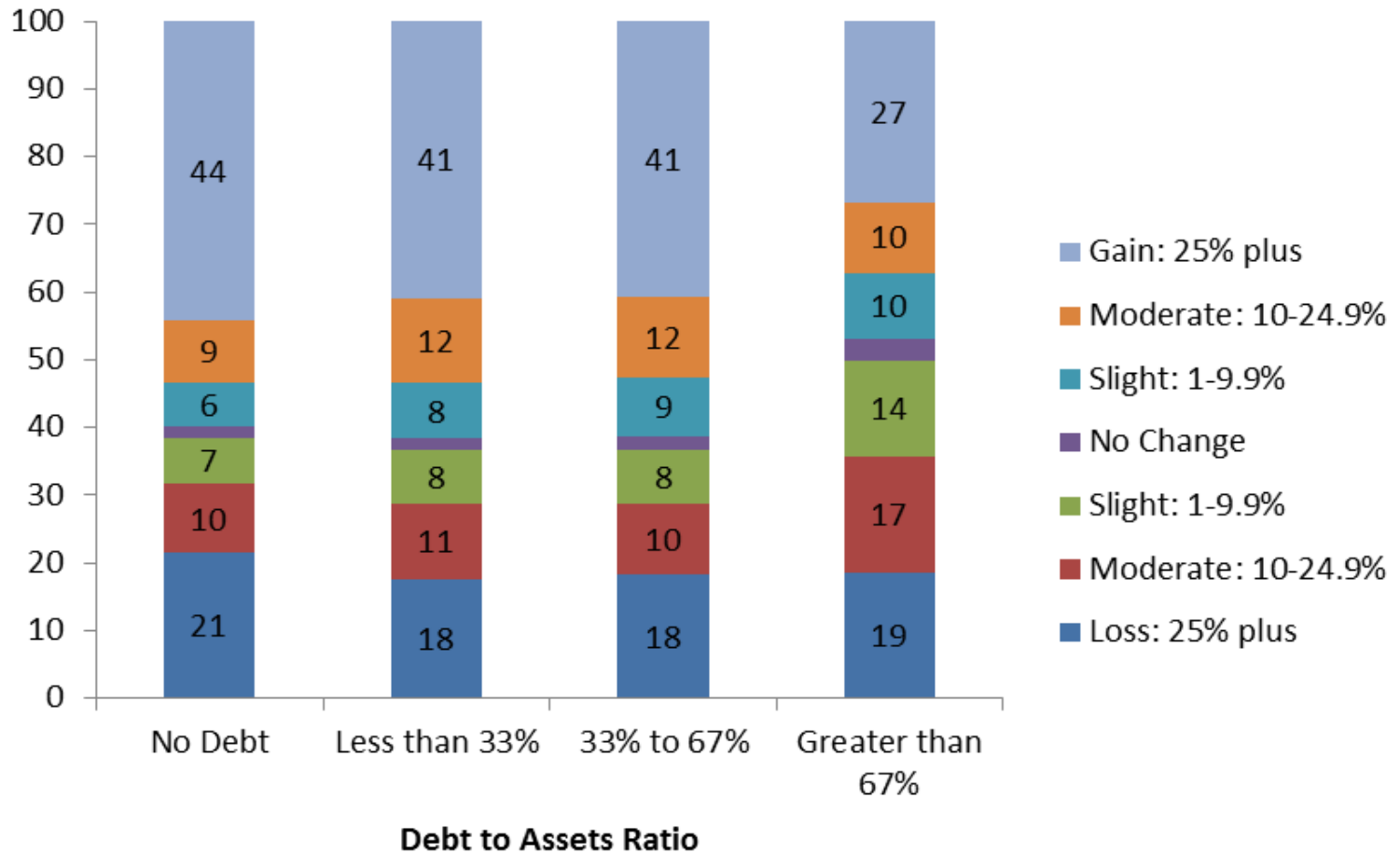
Source: National Center for Charitable Statistics, Core 2012 Public Charity Full 990 File

Growth in Revenue (Inflation-Adjusted) by Debt Category, 2003-2012



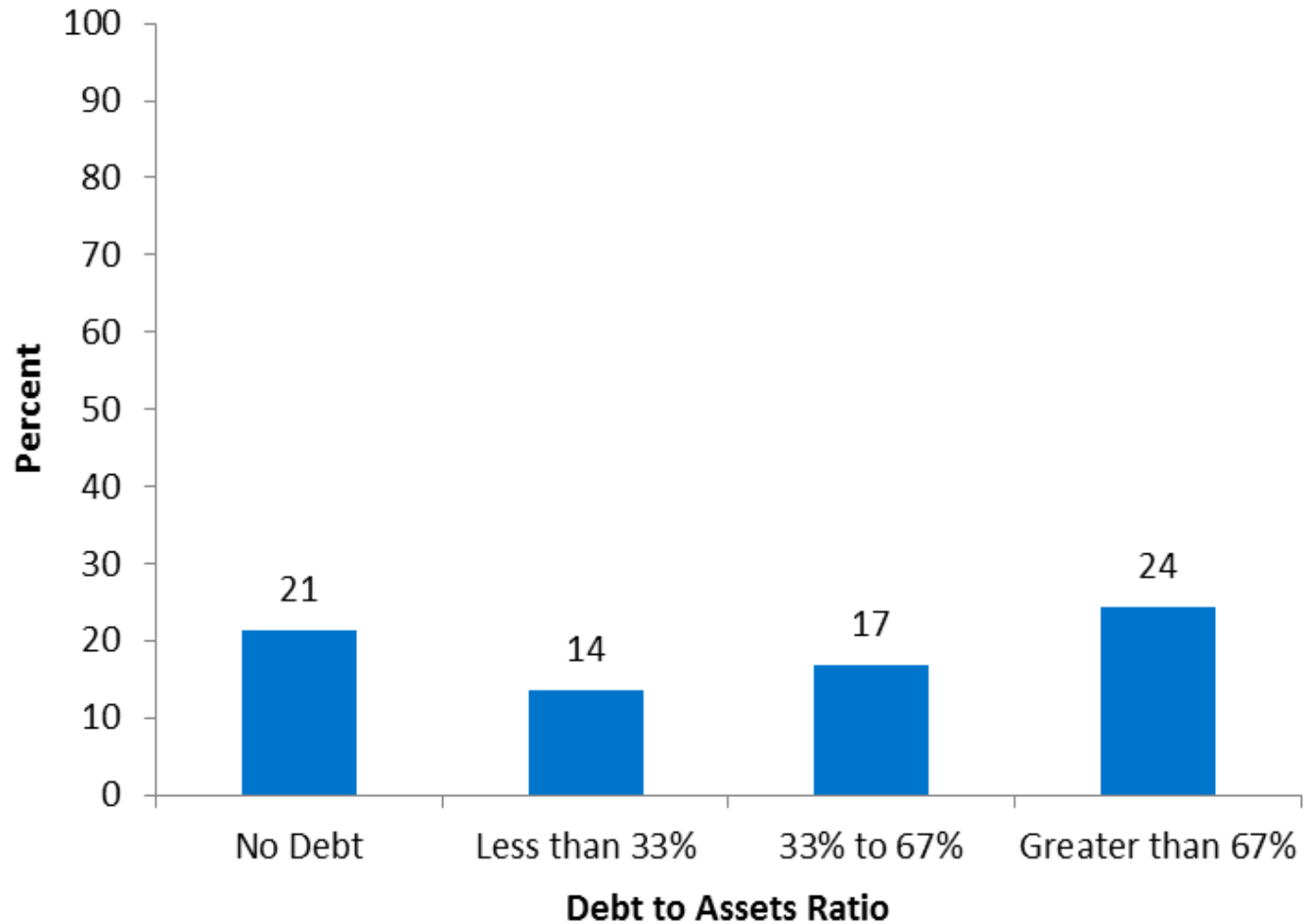
Source: NCCS-GuideStar National Nonprofit Research Database, 1998-2003; NCCS Core 2012 Public Charity Full 990 File

Growth in Expenses (Inflation-Adjusted) by Debt Category, 2003-2012



Source: NCCS-GuideStar National Nonprofit Research Database, 1998-2003; NCCS Core 2012 Public Charity Full 990 File

Closure Rates by Debt Categories, 2003-2012



Source: NCCS-GuideStar National Nonprofit Research Database, 1998-2003; Business Master File 2012

How Public Charities Use Debt?

Short-term Needs vs. Long-Term Needs

- 2014 Nonprofit Finance Fund State of Sector found that many nonprofits are using debt to smooth uneven revenues and expenses.
- A look at the audited financial statements of a sample of 100 public charities in Massachusetts that had reported debt on their Form 990 in 2012, revealed the following
 - More than half are using it to meet short term capital needs. Fifty-five percent of these nonprofits either used or had access to a line of credit.
 - More than three-quarters of charities used debt to purchase real estate or expand/renovate existing facilities.

Estimated Percentage of Public Charities Using Debt for Real Estate by Size, 2012

Organization Size (Total Expenses)	Land, Building, and Equipment Basis			
	< \$100,000	>= \$100,000	>= \$500,000	>= \$1 million
Less Than \$250,000	2	34	40	42
\$250,000 to \$500,000	4	44	53	54
\$500,000 to \$1 million	6	47	55	58
\$1 million to \$5 million	8	51	59	63
\$5 million to \$10 million	10	56	63	67
Greater than \$10 million	9	66	70	73
All	4	48	57	62

Source: National Center for Charitable Statistics, Core 2012 Public Charity Full 990 File

Conclusion

- Relatively few public charities use debt.
- Larger, well-established charities with more reliable cash flows and collateral to secure the debt are more likely to use debt.
- Public charities most often use debt to meet short-term capital needs and finance real estate purchases rather than using it to expand programs and services.
- Insights into the potential effect of impact investing on the financial health of the sector?

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Nonprofit Capital Investment and Management of Balance Sheets

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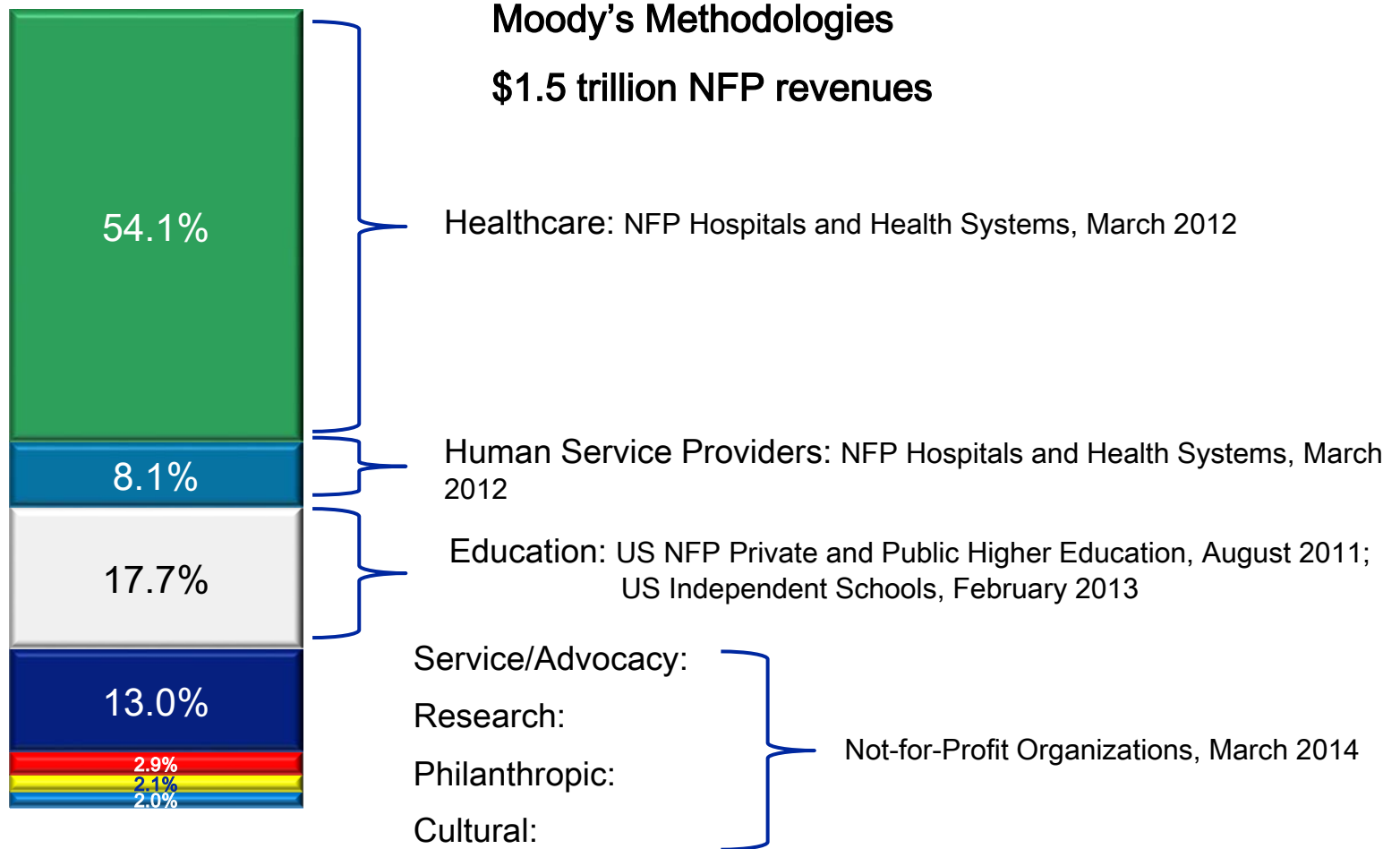
October 23, 2014

Dennis Gephardt

Vice President and Senior Analyst

Moody's

Four primary methodologies govern diverse private not-for-profit organizations in the US



Source: The Urban Institute, National Center for Charitable Statistics; Internal Revenue Service, Exempt Organizations Business Master File (2013, Feb)

Capital intensity varies by sub-sector

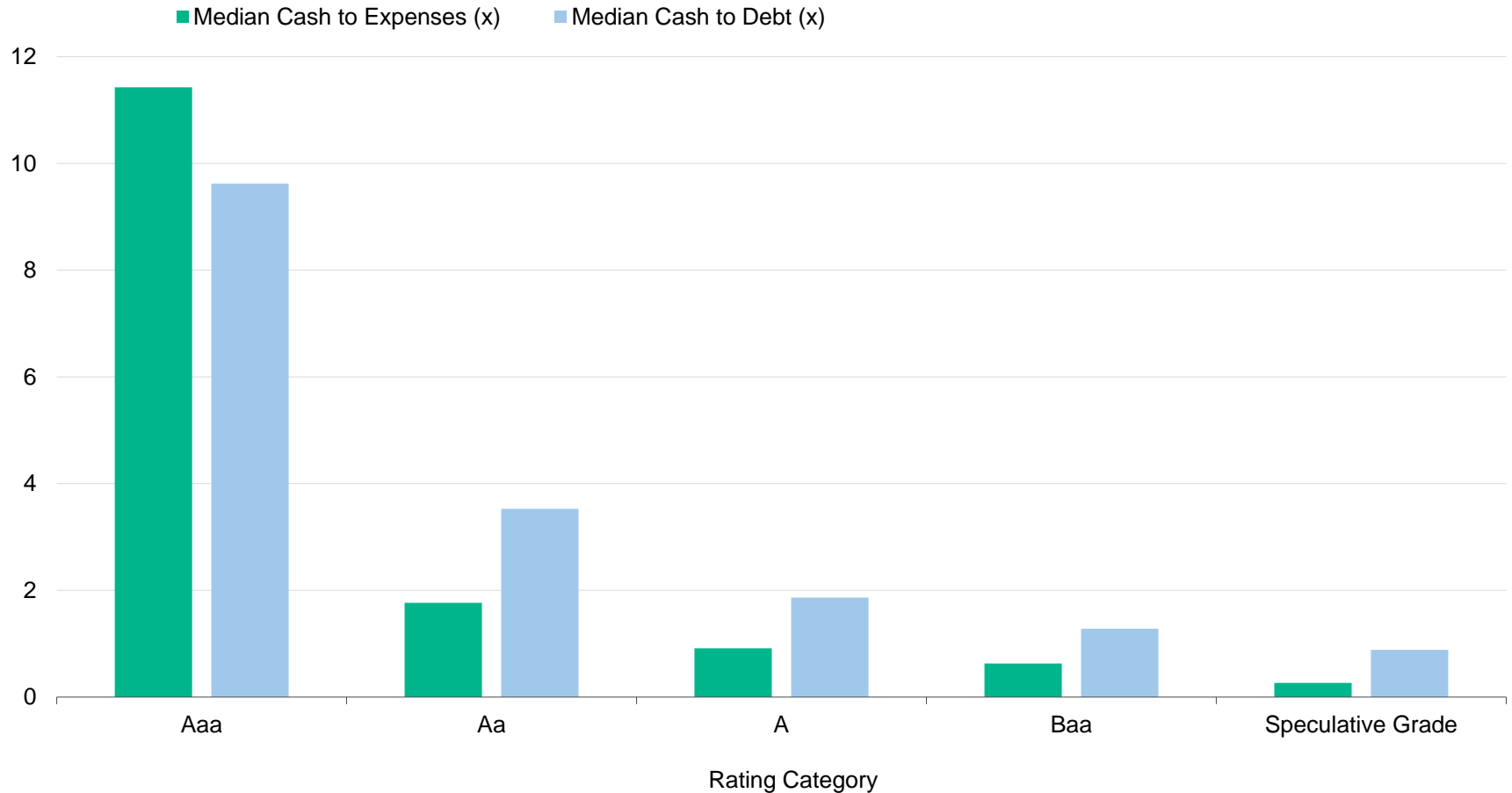
Sub-Sector	Median Capital Intensity*	Median Debt to Operating Revenues
Cultural Organizations	2.05	1.26
K12 Private Schools	1.89	0.86
Private Higher Education	1.37	0.69
Research Institutes	0.92	0.62
Healthcare	0.53	0.38
Service / Advocacy	0.44	0.40
Philanthropic	0.15	0.68

Data are for Fiscal Year 2013

*Capital Intensity = PPE (net) / Operating Revenue

Source: Moody's Investors Service

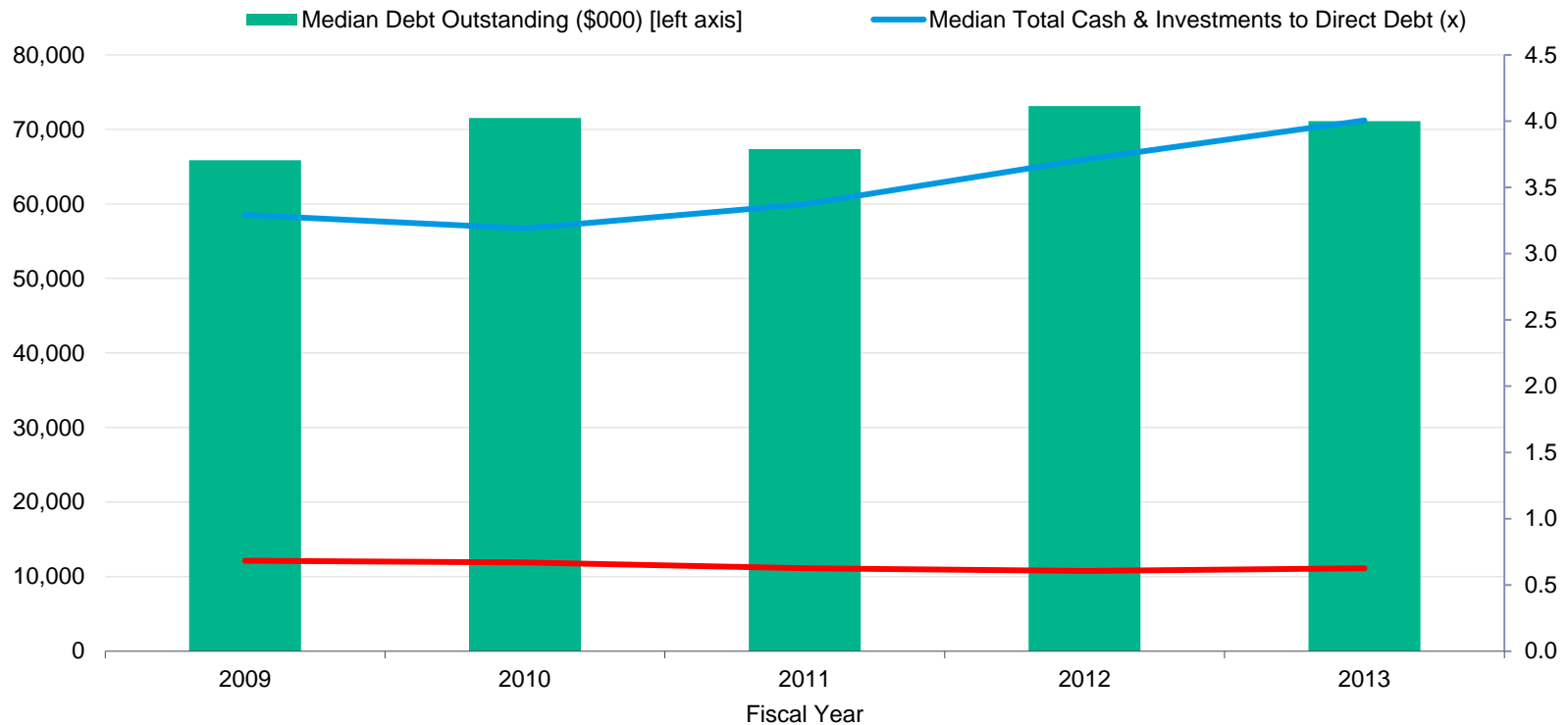
Distinguishing features of not-for-profit balance sheets



Data are for Fiscal Year 2013
Source: Moody's Investors Service

Most not-for-profits have manageable debt burdens

- » Median amount of outstanding debt is just over \$70 million. This equates to approximately 60% of operating revenues.
- » The median amount of the budget devoted to debt service is under 4%.



Source: Moody's Investors Service

Balance sheet and capital investment factors account for largest share of Moody's quantitative grid scorecard

Not-For-Profit Quantitative Grid Weights	Standard Weighting
Factor 1: Market Position:	35%
Operating Revenue (\$000)	25%
Average Gift Revenue (\$)	10%
Factor 2: Operating Performance:	20%
Operating Cash Flow Margin (%)	5%
Average Debt Service Coverage (x)	5%
Revenue Diversity (Max Single Contribution) (%)	10%
Factor 3: Balance Sheet and Capital Investment:	45%
Total Cash and Investments (\$000)	10%
Expendable Financial Resources to Direct Debt (x)	10%
Expendable Financial Resources to Operations (x)	10%
Debt to Operating Revenues (x)	5%
Monthly Days Cash on Hand (x)	5%
Monthly Liquidity to Demand Debt (%)	5%

MARCH 19, 2014

CREDIT POLICY

MOODY'S
INVESTORS SERVICE

RATING METHODOLOGY

Not-for-Profit Organizations (other than Healthcare and Education)

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Analyst Contacts:

NEW YORK	+1.212.553.1653
Dennis M. Gephardt	+1.212.553.7209
Vice President - Senior Analyst	dennis.gephardt@moodys.com
Edith Behr	+1.212.553.0566
Vice President - Senior Credit Officer/Manager	edith.behr@moodys.com
Susan Fitzgerald	+1.212.553.6832
Senior Vice President	susan.fitzgerald@moodys.com
Karen Kedem	+1.212.553.3614
Vice President - Senior Analyst/Manager	karen.kedem@moodys.com
Kendra M. Smith	+1.212.553.4807
Managing Director - Public Finance	kendra.smith@moodys.com

Summary

This rating methodology explains Moody's approach to assessing the credit risk of not-for-profit organizations other than those providing healthcare and education. It provides a reference tool that can be used when evaluating credit profiles for not-for-profits, helping investors, borrowers and other interested market participants understand how key quantitative and qualitative characteristics affect rating outcomes. The report provides a detailed guide to the six main analytical factors and related ratios that drive ratings in this sector. It is not an exhaustive discussion of every ratio or sub-factor that might be considered relevant in determining an individual not-for-profit's unique credit attributes. Related sectors not covered in this report include not-for-profit higher education,¹ independent schools,² and not-for-profit healthcare organizations,³ for which separate methodologies exist.

Not-for-profit ratings are based on our analysis of six credit factors:

- » Market Position
- » Operating Performance
- » Balance Sheet and Capital Investment
- » Governance and Management
- » Legal Security and Debt Structure
- » Other Credit Specific Considerations

This methodology updates and replaces *Moody's Rating Approach for Not-for-Profit Cultural Institutions* (November 2004). It also serves as the initial published methodology for philanthropic, research and service/advocacy organizations.

The methodology introduces a scorecard with weights assigned to 11 quantitative sub-factors. The quantitative portion of the scorecard is a tool designed to provide clarity around the rating process, but is not intended to provide an exhaustive treatment of all factors. In addition to the quantitative factors, the scorecard incorporates several qualitative factors.

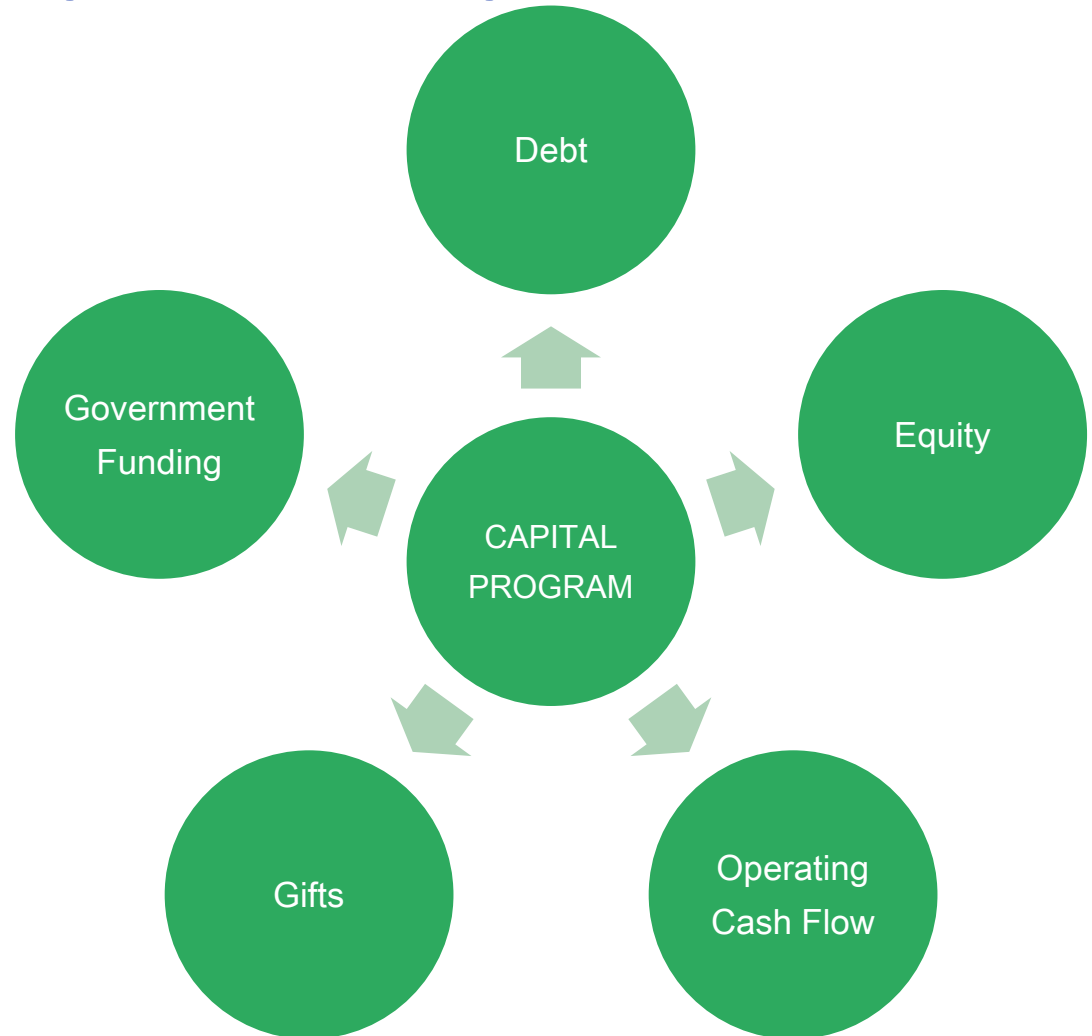
¹ U.S. Not-for-Profit Private and Public Higher Education, August 2011

² US Independent Schools Methodology, February 2012

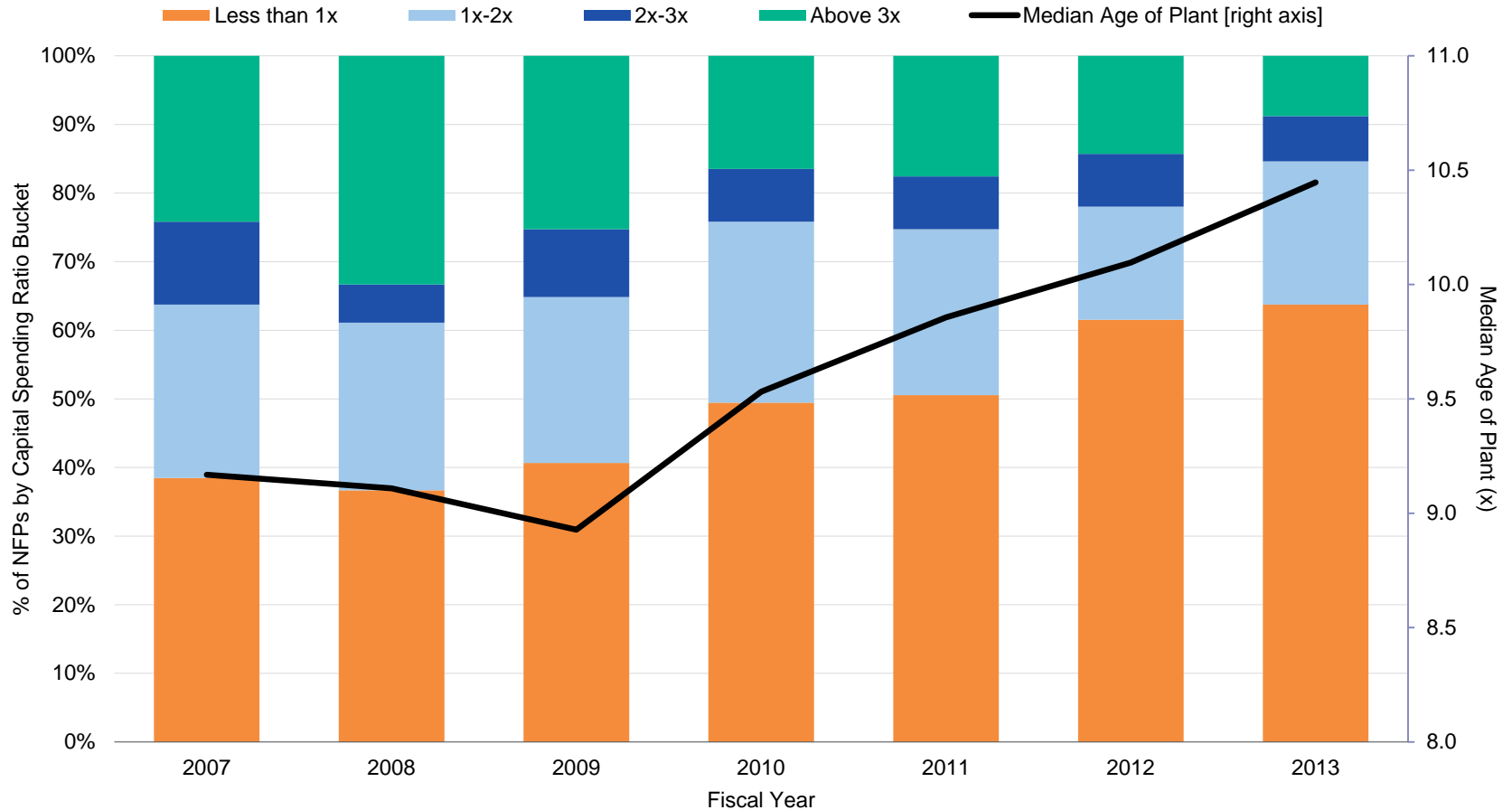
³ Not-for-Profit Healthcare Rating Methodology, March 2012

Diverse sources of funding of capital programs

- » The financially strongest not-for-profits have a mix of funding sources.
- » Choice of funding instrument can vary by project purpose, expected repayment mechanism, and the expected useful life of the asset.
- » Borrowing can either be done in the public market, through bank loans, or via private placements with a variety of sophisticated investors.



Capital spending has slowed as plant needs are deferred



Source: Moody's Investors Service

Debt policies help guide the decisions of not-for-profits

Debt policies establish how debt will be used and the organization's tolerance for risk

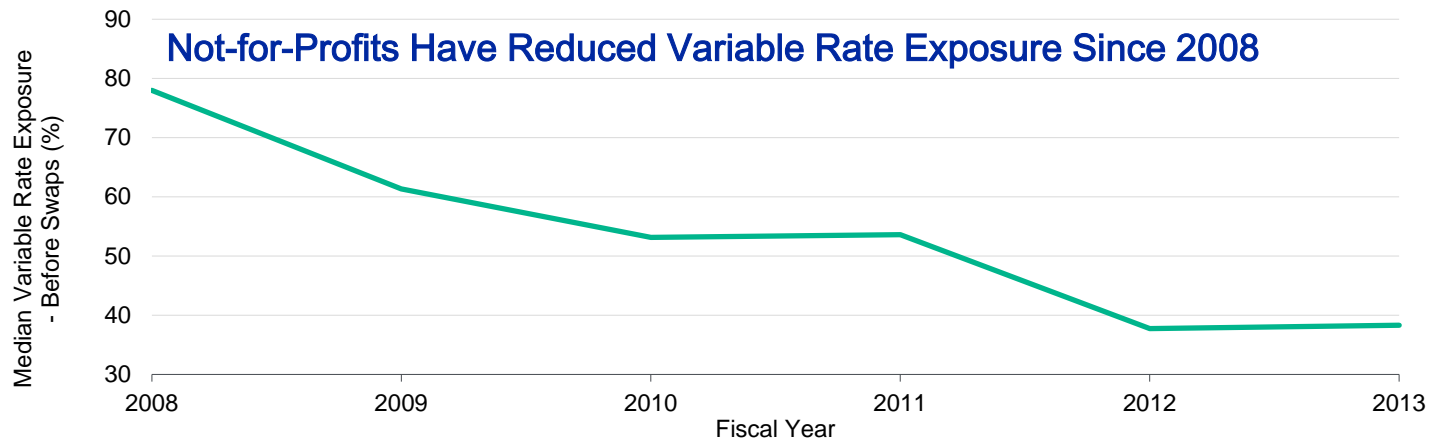
- Capital needs and/or operating needs
- Debt structure, including use of variable rate debt and derivative instruments
- Establish guardrails on amount of leverage

Debt policies incorporate planned repayment

- May include board vetting of a cash flow plan for each major borrowing
- Bridge financing of gift expectancies may require a threshold of fundraising success before borrowing

Stronger debt policies not static but subject to monitoring and periodic review

- Long-term commitments generate ongoing demands, external reporting, and creditor relationship management



Source: Moody's Investors Service

Debt structure can introduce unique risks

Risk	Bank Debt	Variable Rate Demand Bonds
Interest rate risk	X	X
Liquidity risk	X	X
Renewal risk	X	X
Remarketing risk		X
Counterparty risk		X

Our credit assessments focus on how not-for-profits manage the associated risks and their ability to respond under various scenarios.

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Webinar #1

Lessons for the Future: The Impact of Recession, and Nonprofit Financial Knowledge

Thursday, September 25, 2014

Webinar #2

Nonprofit Governance and the Role of the Board in Financial Management

Thursday, October 9, 2014

Webinar #3

Recent Trends in Nonprofit Balance Sheets and Capital Investment

Thursday, October 23, 2014

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Indianapolis

Thank You!

Dennis Gephardt

Vice President and Senior Analyst

Moody's

Dennis.Gephardt@moodys.com

212-553-7209

<http://www.moodys.com>

MOODY'S

Tom Pollak

Program Director

National Center for Charitable Statistics at the Urban Institute

tpollak@urban.org

202-261-5536

<http://nccs.urban.org>



Una Osili

Director of Research

Indiana University Lilly Family School of Philanthropy

uosili@iupui.edu

317-278-8908

<http://www.philanthropy.iupui.edu>



LILLY FAMILY
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