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Purchasing Real Estate as a Nonprofit

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Purchasing Real Estate as a Nonprofit

For a nonprofit, the mission drives the organization. Therefore, every decision must somehow support and align with the mission. When considering whether to purchase real estate, the leadership team and board must look at each component of the prospective purchase, keeping in mind their fiduciary responsibility to make sound financial decisions that support long-term viability. The evaluation process typically begins with scrutinizing the financial aspects and ends with an understanding of how the physical space and location support the vision. It is important to remember that no part of the process can be done independently; examine each component and carefully consider how it impacts other elements.

Determining the location for an organization is one of the most important decisions a leadership team will make. From considering the monthly expense of a lease or mortgage to evaluating how location might impact the ability to serve clients, the financial implications are far-reaching. Nonprofits, like their for-profit counterparts, face challenges in determining a location — and arguably with greater complexity. A nonprofit will often have a myriad of people to consider, from the communities they serve, to the donors, volunteers and employees who help the organization thrive. Organizations must be able to satisfy stakeholders' needs while keeping a steadfast focus on the mission.

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Engaging the Experts

Recognizing where resources and expertise are best utilized is key. For example, an executive director's role is to lead and grow the organization. This individual should not also be expected to have the architectural knowledge to determine whether a building has great potential, up-to-the-minute knowledge of comparable listings, leases and market conditions, or the extensive financial knowledge needed to best determine whether a capital campaign is truly feasible. From brokers and architects to bankers, attorneys, and seasoned nonprofit leaders, experts can help evaluate the market and associated costs, and ultimately aid in forming the basis for a decision that will prove best for the organization.

Nonprofits should not underestimate the value of their board and the need for its members to assist in the process. Having access to a diverse set of skills is essential to the survival of a nonprofit, particularly when considering a real estate purchase, emphasizes Verna Wise, executive director of Ophelia's Place in Eugene, Ore. A nonprofit needs a balance of mission-specific experience and business savvy in order to survive this economic climate. Furthermore, the more the board is engaged, the more likely they are to provide critical support from both an execution and fiscal standpoint. Engage both the board and a team of experts early on to ensure a thorough evaluation process.

Seeking Stability

In many cases — and particularly over the long term — owning property offers greater stability and lower monthly expenses due to favorable tax exemptions and financing options for nonprofits. The following are a number of benefits to ownership:

Stability – Owning property creates stability for an organization, both from the standpoint of ensuring a predictable monthly mortgage payment to creating consistency for everyone relying on the facility, including staff, volunteers and the community the organization serves.

Presence – Owning property allows nonprofits the opportunity to create a long-term, established presence in the community.

Equity – Property is an asset that can be leveraged for other uses. For example, organizations have the option to lease unused space, which can create an income opportunity.

Tax benefits – Nonprofits designated as 501(c)(3) are exempt from property taxes.

Favorable financing – Many financing options are available to nonprofits. For example, the Oregon Facilities Authority (OFA) offers low-cost financing through the use of tax-exempt conduit revenue bonds to assist with both small and large needs.

Increased donor commitment – Potential donors tend to look for signs of longevity and may prefer to support a single, clearly communicated cause, championed by a stable organization.

Control – Ownership gives a nonprofit control over how facilities are used.

Ownership does not come without risks and concerns. Owning property will likely make an organization less liquid in the short term while also limiting flexibility in regard to space. If a nonprofit is at a point where the future is uncertain — either in terms of facing growth or potential decline — then it's important to select a location that will offer room for change. In both scenarios, becoming tied to a location that may not support the organization's needs can be detrimental. For example, if a company is on a strong growth trajectory, a lack of liquidity could make it difficult to access cash needed for hiring, fundraising support or other tools required to deliver services.

Lease Versus Purchase

Typically, space-related costs account for a significant portion of an organization's monthly expenses. The ability to accurately control and manage this cost will have a meaningful impact on growth, as predictability allows for more accurate future planning. When considering leasing or purchasing, determine which option will allow for the greatest stability and longevity.

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Leasing a property is often the default choice for many nonprofits because of the flexibility and seemingly lower costs. In actuality, this can be the more expensive and risky option. Tenants face potential increases each time the lease is up for renewal, along with the very real concern that a building could be sold or repurposed, forcing relocation at any given time. For all organizations, moving presents a significant expense. From the cost of movers, furniture, legal fees for lease reviews, installing voice, data, audio/visual, and security to the time required to secure, prepare, and execute the transition, moves are expensive from both a fixed and opportunity cost perspective.

For many nonprofits, facilities are directly tied to the mission and go beyond simply housing administrative functions. For Eugene, Ore.-based ShelterCare, a nonprofit offering housing for those who are homeless or facing homelessness, the risk of losing its facilities threatens the mission. ShelterCare Chief Operations Officer Erin Bonner describes a feeling of vulnerability and lack of control prior to purchasing three of the eleven facilities it operates. With the potential for landlords to be unresponsive and allow maintenance needs to go unmet or lease costs to continually increase, an organization may be left with little control to help those it is trying to serve. In a lease situation, an organization risks having its facilities sold. In such an instance, the organization may be given little time to vacate. Finding a new space in a short amount of time can prove to be an enormous burden from both a mission and cost perspective, creating concern that the organization might not be able to find a viable solution. For an organization like ShelterCare, that would mean being unable to house the residents who depend on it.

Internal Evaluation and Readiness

Organizations are best advised to wait until they are in a stable, predictable position and have a solid understanding of their three-to-five-year plan before moving forward with a purchase. While working closely with a designated team of experts and the board, here are questions and points to consider in evaluating whether leasing or buying is a better decision:

1. Can the organization survive events that require a change in location (e.g., rising rents, sale of property, redevelopment)?
2. Is the organization committed to a single community? In other words, if forced to relocate, would finding a new location in a specific area be challenging?
3. Does the organization have enough control over the current space to accomplish its goals over the next five years? How is the landlord relationship? Is there a firm grasp on potential rent increases in the near and long term, the ability to secure a longer-term lease with renewal options and a clear sense of a landlord's tenant improvement allowances?
4. Could the organization cover regular maintenance costs currently provided by the landlord? This is especially important when factoring in the age of a building.

For each of these questions, consider how the answer impacts stability, longevity and support of the mission.

If a real estate purchase is the right choice for an organization, there are many "next steps" that need to happen in conjunction with one another, ranging from determining specific location and physical needs to identifying sources of capital.

Make cash-flow planning a critical component of the process.

Raising Funds

There are several common sources for funding a real estate project, including agency cash, foundation grants, capital fundraising campaigns, donor support, government funds and loans. Many projects require a combination of sources. Foundation grants, government funds and capital campaigns can take years to secure. Make cash-flow planning a critical component of the process.

Identifying and raising the funds needed requires expertise and experience in this particular area. External consultants can conduct a feasibility study to help determine whether a sufficient donor base and community support exist to produce the money an organization hopes to raise in a capital campaign. Consultants can guide an organization through the steps of recruiting leadership, communicating progress, recognizing volunteers and providing education to the organization on what it will mean to operate at a new, higher level. They are a terrific resource for establishing overall readiness.

Preparing to raise funds through a bank loan will similarly involve internal evaluation, but more from the financial readiness perspective. Organizations will often need to produce the following documentation in order to apply for a loan (note that additional documents may be requested; this is an overview):

- Three years' history of financial documents.
- Three years of 990 tax returns or three years of audited financial statements.
- A year-to-date financial statement.
- Current accounts or pledges receivable aging.
- Current accounts payable aging.
- Budget projections, current-year actuals and current-year budget.
- Next year's month-to-month budget.
- Additional associated costs, such as an appraisal and other external evaluations, as needed.

Make sure the source of your funding allows you to use the money as you plan.

Applications for grants, government funds or real estate-specific loans will have their own unique requirements. Before determining the best path for raising capital, do a thorough cost-benefit analysis of the different options and determine which is best for your organization. Most importantly, make sure the source of your funding allows you to use the money as you plan. Some foundation grants have restrictions and may not recognize mortgage payments as an allowable use.

It is important to remember that purchasing real estate is not a one-size-fits-all solution. The method and use should be tailored for each individual organization's need. For example, ShelterCare took a unique approach when seeking a location, which has worked remarkably well for its needs. Rather than embarking on a capital campaign to raise the funds to purchase the property, it used existing cash to purchase property and then initiated a capital campaign combined with a bank loan to support growth and replenish cash reserves. ShelterCare was able to leverage the equity in its property to help secure a loan in order to support and augment the capital campaign. The campaign proved more successful than anticipated, with donors able to see an established long-term facility to help support the organization's growth, those it serves and, ultimately, its mission.

Conclusion

The most important thing to keep in mind when deciding whether to purchase or lease a property is not to become fixed on one particular option. Be committed to executing the mission and establishing an organization that can be sustainable and viable long term. With this approach, take an unbiased and thorough look at the organization's current state, five-year plan, role in the community and financial forecast. Consider which option is best for today and in the long term and determine the path required to get there.

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About Pacific Continental Bank

For more than 40 years, Pacific Continental Bank has served the Pacific Northwest with a focus on building long-term business-banking relationships. And along the way, we have forged a strong reputation as a proven business resource and proud civic partner. Pacific Continental Bank's strength lies in our extensive expertise in banking community-based businesses, professional service providers and the nonprofit sector. This expertise means we can help clients tackle the financial issues specific to their enterprise. What's more, clients have access to local bankers who have the authority to make decisions for them on the spot.

Pacific Continental Bank maintains a strong connection to the communities where we operate. The bank empowers its employees to actively engage in fostering an environment where all community members can flourish. We endeavor to work with local nonprofit organizations and community-based businesses, ensuring more dollars stay close to home. The bank supports hundreds of nonprofit organizations in achieving their missions — both philanthropically and through direct participation.

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