

Depleted Endowment? The Answer May Be at Your Feet

By Judith Ashton and Kenneth J. Mickiewicz



J Ashton and K. Mickiewicz

The story is familiar. A quality nonprofit institution depletes its budget and erodes its small endowment in serving its constituents. The tale need not end tragically in job losses and the demise of cherished community resources.

Solutions for financial declines range from obtaining asset-based loans to merging with other like entities. Entrepreneurial activities may also restore an institution to robust health. The Girl Scouts net income selling cookies (especially the thin mints) and the Lance Armstrong Foundation raises funds from the sale of its ubiquitous yellow wristbands. NYU Law School actually once owned and managed the Mueller Noodle

Company. Many nonprofits, though, have neither the human nor financial resources to establish and run entrepreneurial enterprises. They may consider selling non-mission related assets.

One nonprofit in eastern Massachusetts, a school for boys with special needs, found a solution right under its feet. Its endowment had never been large, yet it had always offered its students significant scholarships. Its mission and resource deficiency were so at odds that by the 1990's the school either had to close or something had to change.

Fortunately, the school sat on over 300 acres of land and was using only one-third of it. Recognizing the land's significant value, the trustees undertook a "highest and best use" examination, formalized a plan to preserve the institution's mission on a portion of the large tract and sell the rest for development. The school leased 65 acres to a developer for 99 years with a purchase option, receiving \$1 million in annual rental income. The developer located a tenant, for which it constructed three research buildings, and the tenant then purchased the entire parcel from the developer and the school.

While not all nonprofits sit on valuable parcels of land, many can convert assets to mission-enhancing tools. Some have received gifts of real estate remote from their operations. In urban areas, nonprofits have sold air rights above their sites, some for substantial revenue. The Christ Church on Park Avenue in New York recently sold such rights to a developer, as did New York's MOMA, the latter netting \$65 million. Others have sold, leased or subleased their sites and moved to less expensive quarters. Creative organizations have sold property easements, rooftop advertising rights, oil and gas rights, and intellectual property. Some have leased unused space for retail or office use and many sell their donor lists.

In exploring an asset sale, nonprofit boards must remain mission-driven at all times and board members must be able to stomach reasonable risk. Such a venture may well fail. Boards contemplating major sales should create a detailed business plan and anticipate all reasonable outcomes. This is an excellent way to make a cost/benefit analysis, determine whether there is a market for the asset, begin planning for contingencies, consider front-end costs and how such a venture would affect day-to-day operations, and decide how the proceeds would be used.

Board members must be open to exploring all options and finding the necessary expertise either on the board or outside to help analyze and direct the search for financial security. Staff, major funders, constituents and the surrounding community must be partners in the process. Legal, financial, appraisal, architectural and other tasks will be delegated to professionals, but the board must drive the process.

Legal concerns when a nonprofit contemplates an asset sale are complex, difficult and many. Nonprofits may have debt restrictions or the assets to be sold may be subject to donor restrictions. The nonprofits' articles of incorporation or bylaws may prohibit or restrict the contemplated transaction. State laws require that the organization receive fair value for the sale and that the proceeds be used for charitable purposes.

When nonprofits engage in profit-making enterprises, they must follow legal advice to assure that they retain their income and real estate tax-exempt status. Both in conducting entrepreneurial activities and in selling assets, the complex federal and state laws governing taxation of unrelated business taxable income (UBTI) must be considered.

In sum, many nonprofits own unrecognized assets that could be converted to working, mission-enhancing tools. Just searching with a different purpose or looking with a fresh eye may provide a valuable option for the institution.

Judith Ashton and Kenneth J. Mickiewicz are shareholders at the Boston-based law firm of Davis, Malm & D'Agostine, P.C., which advises nonprofit organizations on day-to-day operations and endowment-enhancement strategies. They can be reached at 617-367-2500 or by emailing to jashton@davismalm.com and kmickiewicz@davismalm.com.