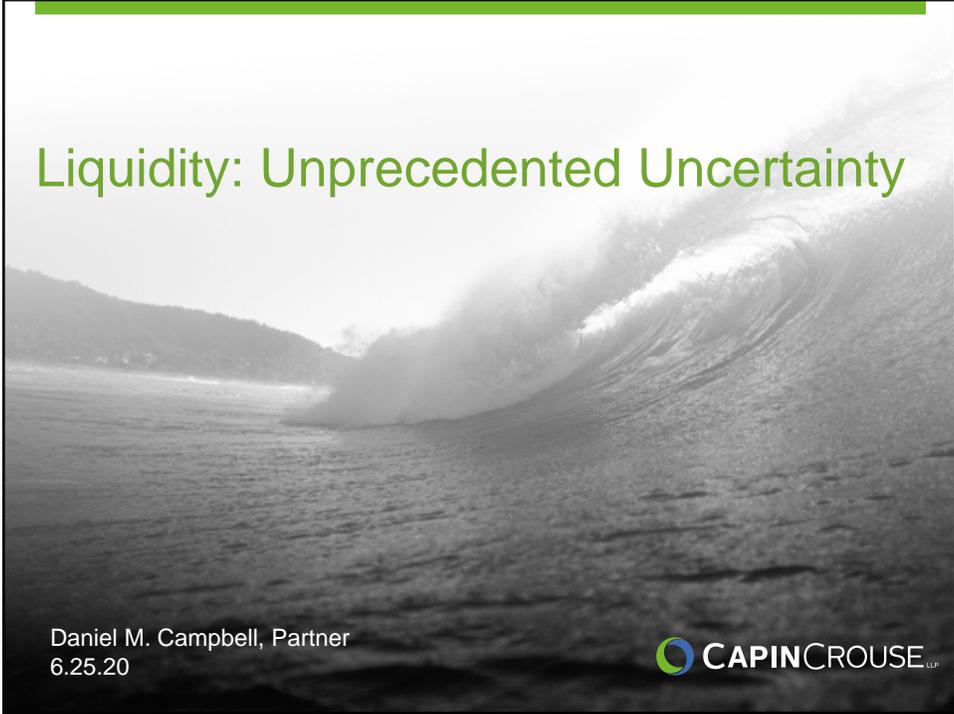


The webcast will start at 1:00 p.m. Eastern

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- Visit [info.capincrouse.com/liquidity](http://info.capincrouse.com/liquidity) to access these materials from today's webcast:
  - Handout
  - Recording
  - "Liquidity – The New Normal" article
- To receive CPE credit you must respond to the polling questions, which are not available on mobile devices. To receive CPE credit you must log in on a computer.
- CPE certificates will be emailed to you within the next few weeks.



## Liquidity: Unprecedented Uncertainty

Daniel M. Campbell, Partner  
6.25.20



## A New Reality

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- Thursday, January 30, 2020 – World Health Organization (WHO) declares the outbreak of a novel coronavirus as a Public Health Emergency of International Concern
- Wednesday, March 11, 2020 – WHO declares COVID-19 disease a pandemic; NBA suspends season
- Friday, March 13, 2020 – A national emergency is declared in the United States concerning the COVID-19 outbreak; NCAA cancels March Madness and spring sports

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## A New Reality

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- Traditional measures of liquidity immediately proved inadequate for many nonprofit organizations
  - Colleges and universities discontinued on-campus operations
  - Churches began holding services remotely
- An organization with six months of operating reserves was once thought to be invincible — COVID-19 proved us wrong

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## What is Liquidity?

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- **Liquidity may not be the most important indicator of financial health, but it is the first**
- Further operational and financial analysis is not necessary if an organization fails the liquidity test
- Measures of liquidity vary in proportion to the definition of it

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## What is Liquidity?

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Defined simply:

*Liquidity is the amount of financial assets available to fund general expenditures.*

*FASB ASU 2016-14*

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## FASB ASU 2016-14

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- FASB ASU 2016-14 requires all nonprofit organizations to disclose relevant information regarding the liquidity of assets, including restrictions and self-imposed limits on use
  - Quantitative display of actual liquid assets (defined as financial assets)
  - Qualitative disclosure of the entity's policies on managing those assets to meet general expenditures
- Provides a consistent and level playing field when assessing organizational health

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## Liquidity Should Be an Important Focus

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John Zietlow:

- Financial health and liquidity should be an important focus for every nonprofit, second only to the actual mission of the organization.
- The financial management objective of a nonprofit is “to ensure that financial resources are available when needed (timing), as needed (amount), and at reasonable cost (cost-effectiveness) and that once mobilized, these resources are protected from impairment and spent according to mission and donor purposes.”

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## Traditional Measures

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- Donative nonprofits – cash reserves equal to 3 – 6 months of expenses
- Business-like nonprofits – 70% or more of funding comes from program revenues
  - Colleges and universities – 4.5 months of operating reserves
  - Hospitals – current ratio of 2.0, cash conversion cycle 64 days and cash on hand 19 days
- These measures suddenly seem inadequate

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## The big question...

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What can organizations do to get immediate liquidity if there's not enough in discretionary cash?

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## Federal Sources of Liquidity



## Federal Sources of Liquidity

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Federal sources of liquidity include:

- The Small Business Administration (SBA)
- The Federal Emergency Management Agency (FEMA)
- The United States Education Department
- The United States Department of Treasury
- The United States Department of Labor
- The Federal Reserve

## Federal Sources of Liquidity, continued

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- A significant amount of uncertainty about the virus and its long-term impact continues
- Unemployment is expected to remain high, affecting certain demographics more than others
- The stress on nonprofit resources and the need for their mission continues during a time when funding and program revenues are uncertain
- Further federal funding is uncertain

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## Operating Margin

## Operating Margin

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- Programmatic activities must create a margin to facilitate growth and flexibility
- “No margin, no mission”

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## Program Revenues

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- Program revenue streams require renewed effort and attention
- Consider program revenue preservation and donor retention efforts with the same sense of urgency applied to operating expenses

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## Program Expenses

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- Missional organizations are aligning financial plans with core values and desired outcomes while shedding non-core programs and activities
- Expense reduction framework to consider:
  - Purchasing programs
  - Utilities
  - Salaries and benefits
- Furloughs vs. layoffs

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## Operational Margin

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- May be your organization's only source of liquidity
- Assess the impact and expected longevity of the current crisis
- Offer essential programs that meet your constituent's needs and contribute to the organization's financial health and flexibility
- A program marginal revenue analysis can help

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## Your Bank – Generating Cash / Improving Ratios

- Education Department now requires new long-term debt to be matched with fixed asset acquisition — you can't merely borrow long-term after 6/30/20 to boost ratios
- Leasing new assets effectively offsets the negative of increased fixed assets with the debt used to acquire it when calculating the primary reserve ratio
- A sale and leaseback provides a net benefit
  - The gain recognized on the sale increases accumulated surplus for primary reserve and net income ratios
  - Lease debt offsets the increase in fixed assets

CFO Colleague

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## Capital Markets

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## Capital Markets

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- Traditional best practices regarding the strategic use of debt continue to be true during a crisis
- Consider financing capital expenditures you may otherwise pay cash for to preserve liquidity
- Application of this strategy could involve the use of capital leases and public-private partnerships
- Lines of credit may be an option

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## Capital Markets

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Thinking about debt?

Leverage makes good decisions better and . . .

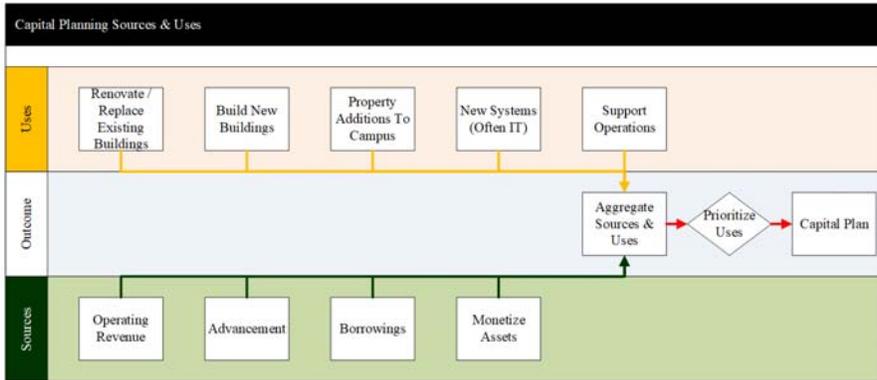
. . . Leverage makes bad decisions worse

*Malcom Nimick*

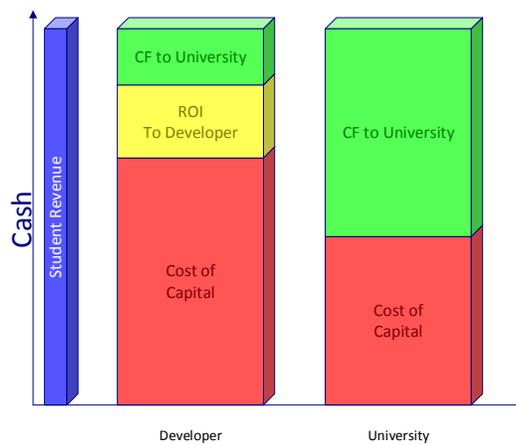
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# Capital Markets

## A Capital Plan Will Consider a Holistic Picture

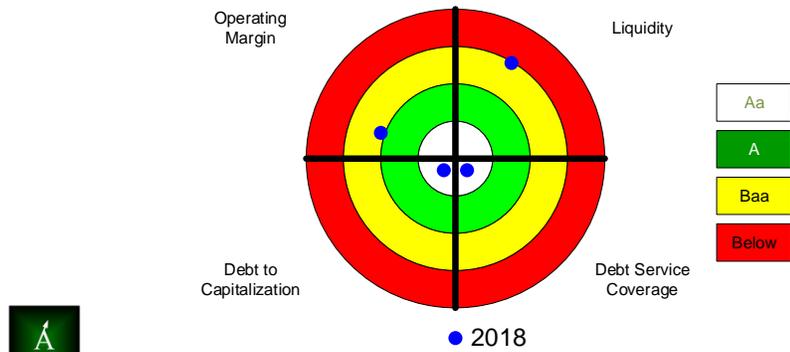


# P3 Partnerships Haven't Worked for 501(c)3s



## Capital Markets

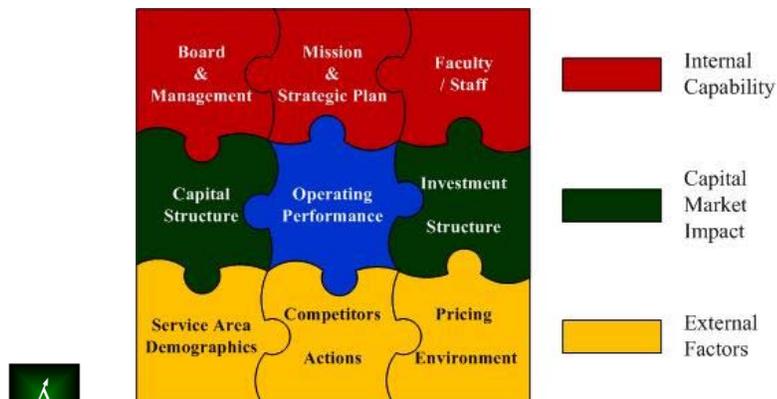
Low debt means good debt ratios. . .  
 . . . also usually means low liquidity



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## Capital Markets

Operating Performance is Key



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## Endowments – Donor-Restricted Investments



## Endowments – Donor-Restricted Investments

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Organizations have fiduciary responsibility to comply with donor wishes and restrictions of fund and earnings use. Use of endowed investments for purposes other than donor wishes and restrictions requires board approval and legal counsel from an attorney familiar with trust and endowment laws in your jurisdiction. Each state's attorney general also has a legal interest in protecting assets.

## Market Update and Outlook

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### February/March downturn was swift

- Global equities<sup>1</sup> fell 34% in 35 days
- Market realized COVID-19 would be significant
- Stocks were richly valued heading into downturn

### Rapid rebound starting late March

- Global equities up 38% since bottom (down 6% YTD)<sup>2</sup>

<sup>1</sup> Morgan Stanley Capital Index All Country World Index Net    <sup>2</sup> Through June 19, 2020



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## Endowments – Donor Restricted Investments

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- Temporarily increase spending rate
- Borrow from the endowment
  - Requires liquidation of assets
- Pledge assets a collateral for a loan or line of credit

*Note: Check governing documents and/or any donor agreements*



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## Market Update and Outlook

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### Today

- Stocks look expensive: more downside than upside
- Bonds could be negatively impacted by inflation



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## Endowments – Asset Allocation

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- Sell from equities (loss may be less than feared)
  - FY 5/31/2020 S&P 500 return: +12.8%
  - FY 6/30/2020 S&P 500 return<sup>1</sup>: +7.4%
- Give liquidation notice on illiquid assets
  - May have three-month or 12-month notice requirement

<sup>1</sup> Through June 19, 2020



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## Disclosures

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[winters@cornerstonemgt.net](mailto:winters@cornerstonemgt.net)



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## Liquidation of Non-missional Assets

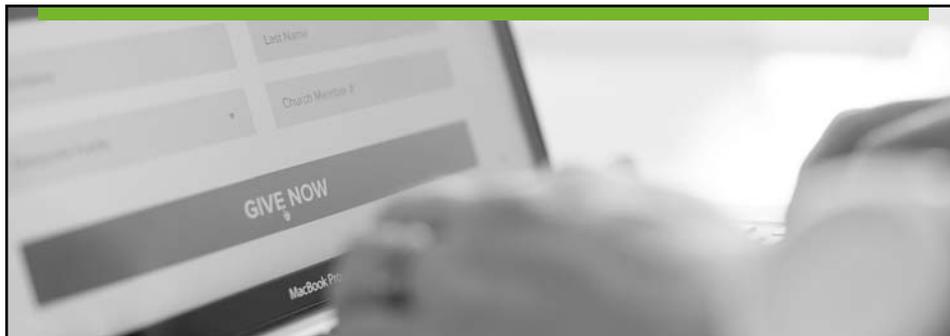


## Liquidation of Non-missional Assets

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- Strategic sales of non-missional assets during a crisis may be a viable solution
- The current economic situation may impair your most marketable non-financial assets
- Assess the impact on your organization's balance sheet and statement of activity

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## Donors

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## Donors

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- Consider new ways to sustain donor relations and support during this period of social distancing
- Determine a number of future operating scenarios and develop a financial model for each
  - Include triggers that will inform management as to the timing and nature of decisions that you need to make
  - Use the models and triggers to calculate the liquidity gap
  - Connect that gap to a fresh and compelling mission for your organization

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## Planned Giving Opportunities

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- Donor-advised funds
  - Reach out to donors with large balances
- Charitable gift annuities
  - Withdraw excess reserves
  - Ask if annuitants will sever contracts
- Charitable remainder trusts
  - Ask if donors will terminate all or part of trust early

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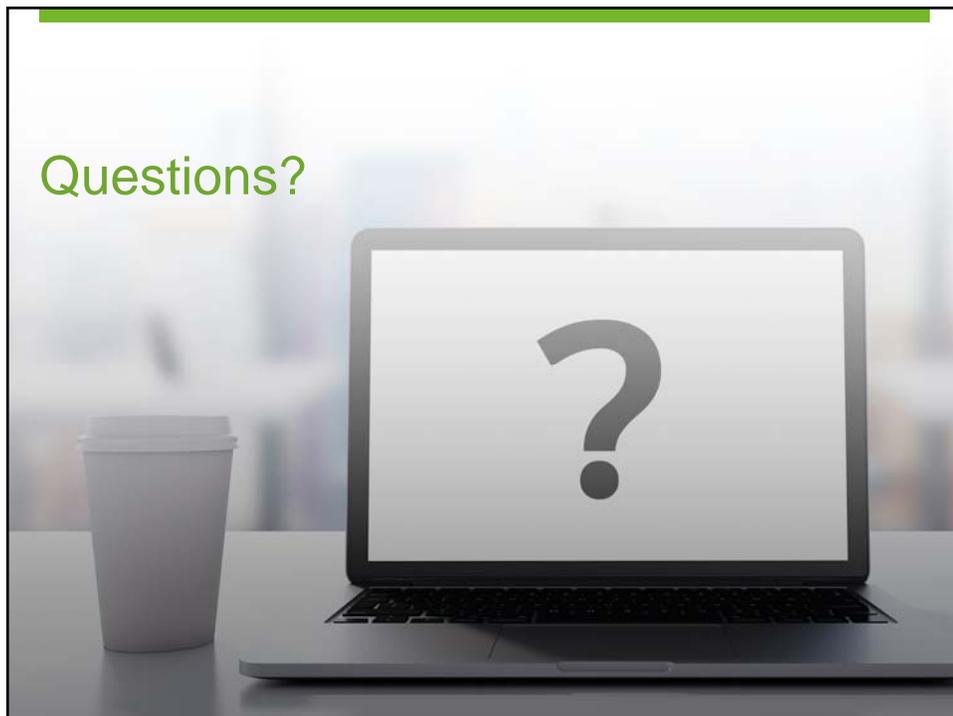
## Last Thoughts

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- Liquidity is king during a crisis of this magnitude
  - Engage in activities that generate it
  - Manage it aggressively
  - Hold on to liquidity until the crisis passes

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Questions?



# Liquidity – The New Normal



- Article with key takeaways from today's webcast
- Watch for the link in the follow-up email or visit [info.capincrouse.com/liquidity](http://info.capincrouse.com/liquidity)

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