



**National  
Center on  
Nonprofit  
Enterprise**

## **Advisory Letter**

### *How Should Our Nonprofit Organization Fund Its Capital Needs?* **John O’Kane**

Traditionally, nonprofit organizations have focused their annual budgets and fundraising on programs and necessary operating expenses. Few have budgeted set amounts for future major capital expenses or to replace depreciated assets. When it came time for a major capital expense, especially a new building, nonprofits would often seek major grants from foundations. In the past, foundations generally served as the main source of capitalization in the nonprofit sector. Since the 2008 recession, however, more and more foundations have shifted their grants towards funding operating expenses, new program initiatives and organizational sustainability.

Some nonprofits have been able to garner capital support from corporations or businesses, especially where there is a strategic or marketing value for the for-profit business. In addition, for nonprofits in the arts, as well as universities and hospitals it has not been uncommon to have a patron or “angel investor” philanthropist foot a large part of a capital campaign in exchange for a naming opportunity.

About twenty years ago, nonprofits began to add maintenance endowments and program start-up and operating expenses to their traditional “capital campaigns”, increasing the size and stature of these initiatives. Capital campaign goals were increased by as much as 40% to offset the increased operating and upkeep of new fixed assets funded by the campaign, in addition to expenses for new programs. In the past, a rule of thumb was that 80% of capital campaign dollars would come from 20% of the donors. Today capital campaigns seek as much as 90% from 10% of its donors.

Before asking “How should our nonprofit fund its capital needs?” leaders should determine whether a major capital acquisition is in the best financial interest of the organization. Many nonprofits desire to own their buildings or capital assets but this is not always the best decision. Owning a building establishes the nonprofit as a property owner with new responsibilities, staff roles and expenses. In my years of conducting capital campaigns, I have found

this particularly problematic with arts organizations which have challenges managing the property and are often tempted to leverage their capital assets (borrow money using assets as collateral) for new or current artistic ventures.

Still, there are many reasons for a nonprofit to own a capital asset including the capacity (if needed) to leverage the asset to assist with cash flow. Moreover, to achieve a nonprofit's mission or goals, it may be necessary for the organization to own a building in a specific location where renting is not an option. Furthermore, a bargain sale or donated building may offer a unique opportunity to own an asset.

In summary, to assess the merits of conducting a capital campaign these key questions should be explored:

- 1) How does owning a building or major capital asset further the mission of your nonprofit organization?
- 2) How will your nonprofit pay for the increased upkeep and maintenance of new facilities, and their amortized payments? How do these fixed costs (incurred regardless of the level of incoming revenue) fit into your business plan?
- 3) Which staff will be assigned responsibility to oversee the operation and upkeep of the new capital asset?
- 4) If you plan to borrow funds to pay for the capital asset, will you have

the discipline and sound financial management to “pay the note”?

- 5) Can the new capital asset generate revenue and are you being realistic about its income producing capability?
- 6) How will you fund depreciation of your capital asset so that its ultimate replacement can be managed?

Lastly, as foundations and individual major donors establish new forms of grants, loans and donations, there may be additional creative ways for nonprofits to capitalize assets.

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