FINANCIAL HEALTH ACROSS TYPES OF COMMUNITY ECONOMIC DEVELOPMENT ORGANIZATIONS

MONEY MEETS COMMUNITY

KEVIN MORRIS | Senior Vice President, NeighborWorks America
CHRIS WALKER | Research Consultant

This is the final report in the Money Meets Community series, which explores the financial resources and lines of business of community economic development organizations across the United States. It was commissioned by the Community Opportunity Alliance (the Alliance), a national nonprofit that builds the community development field. The Money Meets Community reports are part of the Alliance's Grounding Values in Research program.

COMMUNITY ECONOMIC DEVELOPMENT (CED) ORGANIZATIONS

work to improve the social and economic well-being of America's low-income communities. These nonprofit organizations include property developers, managers, lenders, planning and organizing organizations, and social services organizations.

SUMMARY

THIS REPORT BUILDS ON THE FIRST FOUR REPORTS IN THE MONEY MEETS COMMUNITY REPORTS:

- REPORT 1: Community Economic Development Organizations & Their Activities
- REPORT 2: Tracing Community Economic Development Funding Flows
- REPORT 3: Community Economic Development Organizations: Geography & Financial Resources
- REPORT 4: Community Economic Development Organizations & Their Financial Health

The financial health of the nonprofit community economic development (CED) sector is critical to the nation's efforts to promote the economic and social well being of low-income communities.

CED organizations with strong cash flows and healthy balance sheets are better able to develop affordable housing and real estate, support small business, and provide services to families in need.

Report 4 in the **Money Meets Community** series outlined our methodology for scoring the financial condition of CED organizations. Our methodology uses Internal Revenue Service (IRS) data on nonprofit revenues, expenses, assets, and liabilities. The scoring is based on a set of validated key performance indicators developed by NeighborWorks America to monitor and support its member organizations.

We know from Report 4 that there are different types of CED organizations as defined by their primary business lines and size. They tend to work in different geographies and rely on distinct revenue sources. Might they also display differences in financial health? In this report we find that:

- **Smaller CED organizations tend to be more financially "fragile" than larger ones regardless of their primary line of business.** For this reason, most CED-sector funding flows through organizations that are in good or excellent financial health. Sixty-one percent of total sector revenue goes through organizations rated as being in good or excellent. Only 11 percent of sector revenue goes through organizations rated as financially "fragile".
- **Our health ratings benchmark organizational financial health against their own peer groups, that is CED organizations that have the same agency type.** Different peer groups, such as real estate developers or service-oriented organizations, do not differ much from one another in terms of their overall health. But this uniformity of health masks differences *within* peer groups; e.g., real estate developers with fewer total assets tend to be less healthy than their larger counterparts.

- **Different types of CED organizations fail our financial fragility test for many of the same reasons, but some organizations experience added challenges.** Social services organizations are more likely to fall short because of low liquidity. Real estate development organizations more often falter for lack of unrestricted assets. Smaller organizations of whatever type are more likely to be "fragile" because their revenues and spending are less stable.

Financial health looks somewhat different depending on the types of agencies involved, which means that both the sources of fragility and the appropriate response will be different as well. Some one-size-fits-all responses are worth undertaking such as helping CED organizations maintain positive cash flow. Other aid should be highly targeted, such as providing developers with access to sources of unrestricted capital.

BACKGROUND

The community economic development (CED) sector consists of some 5,700 CED organizations devoted to improving the social and economic wellbeing of America's low-income communities.

The sector includes organizations that engage in diverse business lines, including real estate development, social services, community advocacy, and more. Local CED organizations are supported by a loose network of government agencies, financial institutions, corporate and private philanthropies, and thousands of community members who contribute time and money to help make their communities better places to live.

The CED sector had $22 billion in total annual revenues in 2018, according to an Urban Institute study.[1] Report 4 documented the financial health of the CED sector overall, on the belief that a healthy industry would more effectively and efficiently deliver projects and programs to lower-income communities. And to the extent that financial fragility is concentrated in geographies of greatest need, a healthier sector means more equitable allocation of effort across American communities.

NeighborWorks America and other national CED intermediaries know that predictable revenues that cover expenses enable CED organizations to achieve organizational stability, sustain project pipelines, and recruit high-quality board and staff. When these organizations have a meaningful surplus of revenues over expenses, they can invest in program improvement, develop staff skills, and track the quality of their community outcomes. Strong balance sheets enable these organizations to self-finance projects and programs in the early stages when it is difficult to raise affordable funding from external sources.

Report 4 described our efforts to translate key financial performance indicators developed and used by NeighborWorks America into a method for estimating financial health using widely-available IRS data. Exhibit 1 in the appendix presents the core indicators that are used in various ways to classify CED organizations into "fragile", "fair", "good", and "excellent" health categories.

> "When these organizations have a meaningful surplus of revenues over expenses, they can invest in program improvement, develop staff skills, and track the quality of their community outcomes.

We found that some 18 percent of all CED organizations can be considered financially fragile — a smaller percentage than some if not most industry observers would guess. This report builds on Report 4 by applying our financial health rating method to different peer groups within the CED sector. Exhibit 2 in the Appendix describes what the financial rating categories mean.

[1] Lydia Lo, Corianne Payton Scally, Jesse Lecy, Shubhangi Kumari, The Financial Health of Community-Based Development Organizations: Using Internal Revenue Service Tax Data to Assess Sector Health (Urban Institute, 2022)

RESEARCH QUESTIONS

Previous reports in this series explored the financial characteristics of organizations that comprise the community economic development (CED) sector. We highlighted the diversity of CED organizations' primary business lines and the multiple types of activities any given organization pursues; the large amounts of money, including government money, that organizations raise and spend; and differences in the types of organizations found in urban and rural areas and the sources of funding they rely on.

All of these factors may influence the financial well-being of CED organizations, which is the topic of this report as well as Report 4. That report detailed the construction of our methodology for rating the financial health of organizations and presented sector-wide figures on the percentages of CED organizations in each of four levels of financial health.

THIS REPORT BEGINS THE TASK OF EXPLORING THE DRIVERS OF FINANCIAL HEALTH, INCLUDING:

1. **Does organizational size have any bearing on financial health?**
2. **Do different types of CED organizations have different levels of financial health?**
3. **Do different types of CED organizations face different financial challenges?**

Answers to these questions should help providers of capital and technical assistance to tailor their support to the specific needs of different peer groups within the CED sector. The analysis relies on a database constructed by the Urban Institute, as augmented by Community Opportunity Alliance staff.[2] This database is more fully described in the Appendix Note, as are some elements of the financial rating methodology.

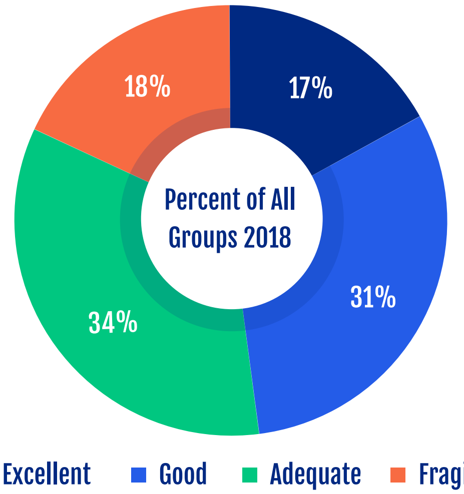
RESULTS

FINDING 1

Larger community economic development (CED) organizations tend to be more financially healthy than smaller ones. *This relates to all types of CED organizations. Sector-wide, most funding flows through organizations that are in good or excellent health.*

Figure 1 shows how all CED organizations fare on our financial health ratings. Eighteen percent scored "fragile," 34 percent rated "adequate," 31 percent scored "good," and 17 percent rated "excellent." The percentage of "fragile" organizations is highest in smaller size categories and declines as these organizations spend more.

FIGURE 1
Financial Health of Nonprofit CED Groups



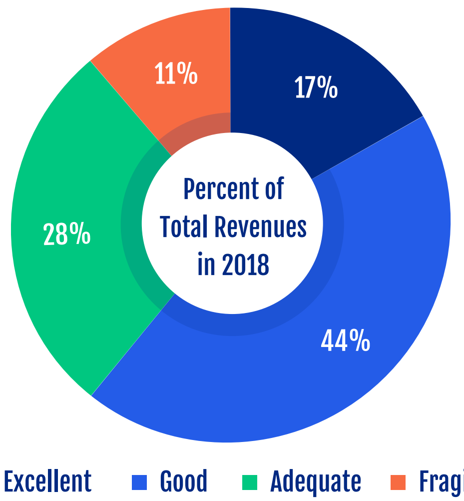
Source: Urban Institute 2018 tax data as augmented and analyzed by Community Opportunity Alliance; Weighted N = 3,248

[2] The augmented database is available on the Alliance's website to enable researchers to carry out their own investigations into CED group finances.

Figure 2 shows how our picture of financial fragility improves as we take revenues into account. Some may think of revenues passing through financially "fragile" organizations as being risky, ineffective, or inefficient investments. However, it is important to consider that the 18 percent of CED organizations rated as "fragile" receive only 11 percent of sector revenues.

> "18 percent of CED organizations rated as "fragile" receive only 11 percent of sector revenues.

FIGURE 2
Revenue by Financial Health of CED Organizations



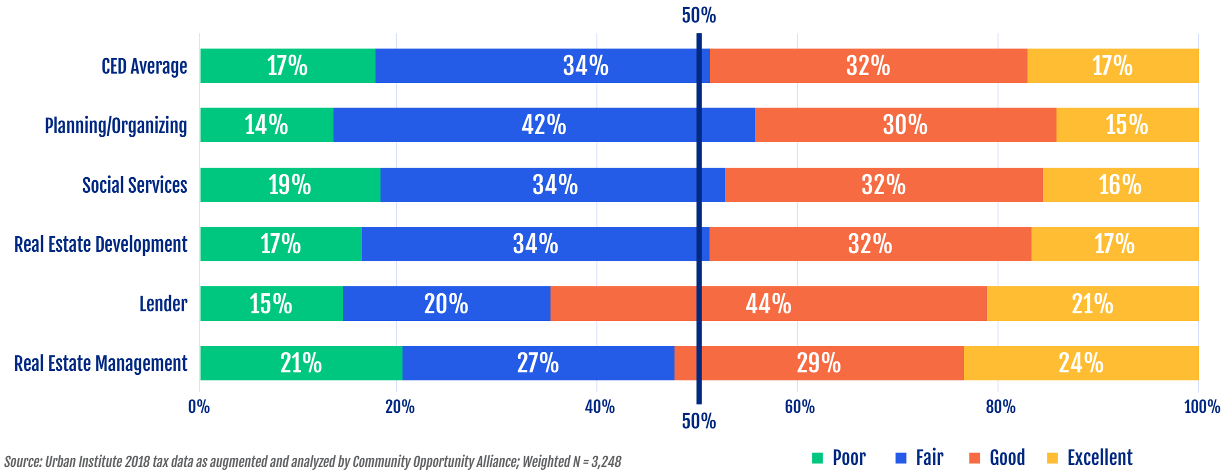
Source: Urban Institute 2018 tax data as augmented and analyzed by Community Opportunity Alliance; Weighted N = 3,248

FINDING 2

Different CED agency types — real estate developers, managers, lenders, social services providers, and planning and organizing groups — have roughly similar financial health ratings. *Partly this is because health ratings are benchmarked to each type of agency, or peer group. We do find, however, that size differences matter more for health in some groups more than others.*

Figure 3 displays the financial health ratings of CED organizations that engage in different primary activities. Our previous research demonstrated that similar CED organizations differ somewhat on revenue sources, average revenues, expenses, and assets. While the figure shows that peer groups do not differ greatly from each other in terms of financial health, this is partly an artifact of the rating method in which "excellent" and "fragile" benchmarks reflect peer group values. That is, the typical financial profiles of the group are taken into account when establishing standards for any individual within it.

FIGURE 3 Financial Health Rating by CED Agency Type (Percent of Groups, 2018)



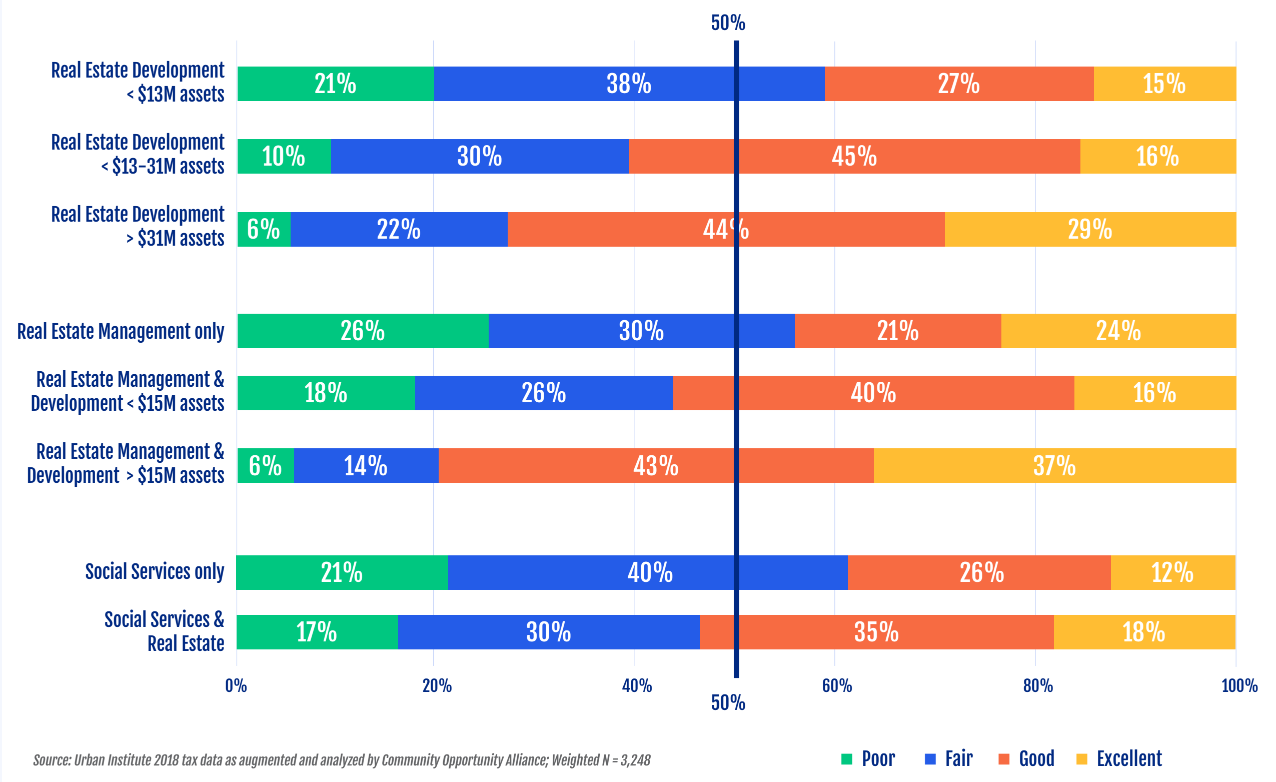
Source: Urban Institute 2018 tax data as augmented and analyzed by Community Opportunity Alliance; Weighted N = 3,248

There are some notable differences. Planning and organizing organizations, social service organizations, and real estate developers display similar financial health profiles. Real estate managers tend to be in somewhat better financial health than other types of organizations. Lenders are in the best health of all. Typically, both real estate managers and lenders can take advantage of steady rental income streams or capital flows. Developers, in contrast, rely on far less predictable infusions of fee income from episodic real estate developments.

Figure 4 presents more discrete breakdowns of agency types based on asset size and shows wider differences in health. Among real estate developers, financial strength is clearly tied to asset size. For example, only 8 percent of the largest developers are deemed “fragile”, compared to 21 percent of the smallest CED organizations. A similar pattern holds for CED organizations that do both real estate development and management. Interestingly, both real estate managers and social services organizations that *do not* do development are in somewhat worse financial shape than those that do development. This finding is likely a function of organizational size. (We know from other research that organizations that engage in multiple activities are larger, on average.)

FIGURE 4

Financial Health Ratings by Selected CED Organizational Subtypes (Percent of Groups, 2018)



PEER GROUPS are organizations that share an agency type, such as property developers, managers, lendiners, planning and organizing organizations, and social services organizations.

FINDING 3

Although some financial tests pose challenges for all CED organizations, some peer groups experience added challenges of their own. *For example, social services organizations are more likely than others to be financially "fragile" based on liquidity measures, even after taking their peer group into account. Real estate development organizations are more often financially "fragile" because they lack unrestricted assets.*

We were interested in learning whether different peer groups rank as financially "fragile" for different reasons. The answer is something of a mix. While there are some common causes of fragility, there are others that are specific to particular peer groups.

Figure 5 examines only those CED organizations that we deemed "fragile," summarizing their performance against each of the financial indicators we used to help categorize them as "fragile." These indicators are grouped into those tied to cash flow, volatility of income and expenses, and assets. The checkmarks in the figure indicate instances in which a particular type of organization exceeds a given indicator's benchmark value on our test of financial fragility. For example, a checkmark in the "days cash" column signifies that the organization is 20 percent more likely to lack of 90-day's cash on hand than are other CED organizations.

Note that almost all CED organizations have trouble with three fragility indicators: negative cash flow in 2018, negative cash flow from operations, and negative change in net assets in at least two of three years. But across the remaining seven indicators, different peer groups have different types of difficulty.

"Fragile" social services organizations are more likely to fail additional cash flow indicators, and this is true regardless of whether they carry out real estate development activities or not. "Fragile"

FIGURE 5 Causes of Fragile Health by CED Agency Type

(Includes Only Groups Scoring "Fragile" on Health Scorecard)

	CASH FLOW				VOLATILITY		ASSETS			
AGENCY TYPE	Negative Cash Flow	Negative Op Cash	Days Cash	3YR Cash	Spending Drop 25	Revenue Drop 25%	Net Asset Change	Asset Drop 25%	Unrestricted Net Income 2018	Unrestricted Net Income
Planning & Organizing	✓	✓			✔	✔	✓	✔		
Real Estate Development < $13M assets	✓	✓			✔	✔	✓	✔		✔
Real Estate Development $13–31M assets	✓	✓					✓	✔	✔	✔
Real Estate Development > $31M assets	✓	✓					✓	✔	✔	✔
RE Management & Development < $15M assets	✓	✓			✔	✔	✓			
RE Management & Development > $15M assets	✓									
RE Management only	✓	✓					✓		✔	✔
Social Services & RE	✓	✓	✔	✔			✓			
Social Services only	✓	✓	✔	✔			✓			

✓ More than 70 percent of groups fail ✔ Groups fail 20 percent more often than average for all groups developers and developers and managers are more likely than other CED organizations to fail spending and revenue volatility tests, as do planning and organizing organizations (which tend to be small). “Fragile” developers across all size categories tend to fail on asset-related tests, as do real estate managers to a lesser extent.

CONCLUSIONS

The previous reports in this series explored community economic development (CED) organizations’ performance across six measures of financial excellence and ten measures of financial fragility, which we then combined into a summary measure of financial health. The findings in this report further validate the conclusions reached in the earlier reports related to the areas of greatest financial vulnerability, the financial needs of smaller CED organizations, and the appropriate response by funders and technical assistance supporters.

Preventing “fragile” performance among the greatest number of CED organizations could best be accomplished by attending to the needs of smaller organizations. This is the case overall, as **Figure 1** showed, but is also true for specific agency types, as shown by the increasing fragility of real estate development and real estate management organizations as their asset sizes decrease. Our previous report in this series identifies some of these needed overlapping policy, technical, and financial supports.

Consistent with our earlier conclusions regarding the importance of increasing unrestricted net assets, days of cash-on-hand, positive net income, and consistent increases of net assets, this report finds that different peer groups face these challenges to different degrees. This means that funders and technical assistance providers, while addressing sector-wide issues like negative cash flow, have an opportunity to customize their assistance to specific challenges faced by each agency type.

Previous reports in this series highlight the importance of social services providers, such as community action agencies, in developing and managing affordable housing, particularly in rural areas. As this report shows, cash flow issues are particularly acute for social service providers as compared to other types of CED organizations. Funders and other philanthropists can help shore up the liquidity of social service organizations by providing operating support or by extending lines of credit tailored to organizations that operate on thin margins.

The same is true of nonprofit real estate developers that rely on the strength of their balance sheets to raise capital, especially in the early stages of project development such as land acquisition and architectural and engineering designs. This report shows the particular importance of unrestricted net assets among financially-fragile real estate organizations. The report pinpoints a need for adequate sources of flexible, low-cost capital of the kind extended through foundation program-related investments.

> “This means that funders and technical assistance providers, while addressing sector-wide issues like negative cash flow, have an opportunity to customize their assistance to specific challenges faced by each agency type.

Although these distinctions among different peer groups are important for policy purposes, they highlight a challenge for the support system for the CED sector. This system consists of a loose collection of national and regional intermediaries that channel financial and technical support to CED organizations and advocate for public policies favorable to community-based development work. Not all of these intermediaries are well-equipped to shape their support to the needs of different peer groups and may lack familiarity and expertise with some activities. The intermediaries themselves may need additional support as they navigate a sector as diverse as community economic development.

APPENDIX NOTE ON RESEARCH METHOD

Financial Health

This research has relied upon a methodology for rating the financial health of community and economic development (CED) organizations developed by Community Opportunity Alliance researchers with the help of NeighborWorks America staff. In the absence of an established method for rating financial health, we constructed one based on the rating criteria already tested in practical use by NeighborWorks staff to assess the financial capacity of their own CED group members.[3]

Elements of the NeighborWorks methodology have been outlined in the text of Report 4 in this series. There are several features worth calling attention to:

1. NeighborWorks relies on information contained in its member organizations' annual audits, supplemented by staff knowledge of group financial practices and organizational activities. In the absence of a national repository of audit information for CED organizations, we relied on data that these organizations reported on IRS form 990s.
2. NeighborWorks conducts separate tests for "excellence" and "fragility" reflecting its concern for promoting CED group financial self-sufficiency, and avoiding financial collapse. For its part, the Alliance's interest in a combined scoring across the full range of financial performance required a combined rating scale that incorporated results from these separate tests.
3. Certain performance benchmarks at the "excellence" end of the spectrum take account of different NeighborWorks group business lines and asset sizes (peer groups) which influence the validity of some tests. These business line classifications are based on NeighborWorks staff's knowledge of organizations' activities, which cannot be exactly replicated using the information available to Alliance researchers.

In view of these differences, we validated our results by trying to replicate NeighborWorks' audit-based results for the 243 organizations included in both Neighborworks' audit and the IRS data. We were able to approximate the NeighborWorks results to a degree, but the resulting estimates are, by design, conservative.

EXHIBIT 1 Financial Health Measures Used to Test for Excellence and Fragility

INDICATOR	"FRAGILITY" BENCHMARKS	"EXELLENCE" BENCHMARKS
DAYS CASH	< 90 days in at least 2 of past 3 years	Stable or upward trend v peers
	< 90 days in current year	
CASH FLOW FROM OPERATIONS		Positive in at least 2 of past 3 years
TOTAL EXPENSES	25 percent drop from prior year	
TOTAL REVENUES	25 percent drop from prior year	
NET INCOME	Negative in current year	
	Negative in at least 2 of past 3 years	
UNRESTRICTED NET ASSETS	Negative in at least 2 of past 3 years	Positive and growing
	Negative in current year	
TOTAL NET ASSETS	Decline in at least 2 of past 3 years	Growth in at least 2 of 3 years
TOTAL ASSETS	25 percent drop from prior year	
DEBT RATIO		Comparable to peers
FINANCIAL SUSTAINABILITY RATIO		At or above peers
CAPITAL RATIO		Positively trending

[3] A more detailed description of this methodology and our testing results is available at https://commoppall.memberclicks.net/-money-meets-community

We tested alternative IRS-based measures of "excellence" and "fragility" until we were able to best reduce the number of false-positives at each end of the spectrum. Our goal was to reduce the number of organizations that scored as "fragile" by the IRS-based method but not by the original audit-based method, and the same for tests of excellence.

As applied to the larger CED population, therefore, the resulting scores most probably slightly understate the percentage of organizations in the larger population that score as "excellent" at the high end and "fragile" at the low end of the health spectrum.

To construct a combined score, we assigned CED organizations that rated "excellent" or "fragile" by the NeighborWorks method to corresponding categories on the Alliance scorecard. We then assigned organizations that scored just under the threshold for excellence (passing three or four of the seven measures instead of the required five) to the "good" category, and the remainder to the "fair" category. (Any organizations that were initially placed in the good category by virtue of their score, but which also failed any of the fragility tests, were assigned to "fair.")

Finally, we approximated NeighborWorks' peer group benchmarks using information on CED group business lines as recorded from organizational websites (see below) and, for certain peer groups (real estate developers, property managers and developers).

EXHIBIT 2 INTERPRETATION OF FINANCIAL HEALTH CATEGORIES

CATEGORY	INTERPRETATION	PERCENT OF CED GROUPS
EXCELLENT Passed 5+ "excellence" measures	Regular achievement of positive net income and positive cash flow from operations; strong liquidity that enables investment in operational improvements; growing net assets and sufficient unrestricted net assets to early-stage project development without resorting to excessive new debt; high liquidity and strengthening balance sheet able to attract new long-term debt on favorable terms; business model often includes earned revenues that more than fully cover expenses.	17%
GOOD Passed 3-4 "excellence" measures	Typically positive net income and operating cash flow; more than 90 days cash on hand, enabling coverage of gaps in revenue flows and modest new investments in operations; solid net asset position and usually positive change in net assets, usually able to partially fund early stage project development; strong capital and debt ratios, but typically less able to cover expenses with unrestricted cash. Able to attract new long-term debt on somewhat favorable terms.	31%
ADEQUATE Passed fewer than 3 "excellence" measures & failed fewer than 5 "fragility" measures	Typically have more than 90 days cash on hand but operating margins are thin and groups are vulnerable to interruptions in revenue making it difficult to plan for program improvement or expansion; some unrestricted net assets are available but net asset growth is uncertain. Capital and other ratios are generally similar to groups in the "good" category enabling them to have at least some capital for investment.	34%
FRAGILE Failed 5+ "fragility" measures	Weak cash flow and very thin or non-existent cash cushion, making it difficult to attract or retain staff and invest in internal operations; negative net assets and lack of unrestricted net assets hampers ability to raise cash to cover gaps in cash flow or raise short-term capital for project development. Relatively high debt burden makes it very difficult to attract investment capital. Often reliant on few revenue sources.	18%

Note: See Appendix for scoring methodology.

Core File Construction

To construct a roster of organizations for this research, the Alliance compiled lists of CED organizations. The lists consist primarily of organizations that are members of state associations that advocate for community and economic development. The lists also include organizations that have received funding from prominent national CED intermediaries or the Federal government.[4] The Urban Institute, under contract to the Alliance, combined these lists and removed any duplicates.[5]

Some 80 percent of CED organizations appeared on multiple sources, giving us a great deal of confidence that our method produced a combined list of organizations that fairly represent the CED sector's most active members. The Urban Institute merged this list with financial information on each organization drawn from the IRS Form 990s, which are the tax returns filed by most nonprofit organizations. Form 990 information consists of detailed breakdowns of organizations' revenues, expenditures, assets, and liabilities. (Note that this information is not as detailed as that contained on audited financial statements.)

As we considered ways to further analyze the data, our advisory group of industry practitioners made clear that financial characteristics of CED organizations — and therefore the indicators of their financial health — are influenced by the types of activities they undertake. But the lists used to construct the CED cohort contained very little information on the organizations themselves beyond name, location, and contact information. The IRS files contain detailed financial information, but not much information on organizational activities.

To find out more about these CED organizations, the Alliance paid graduate students to review websites for a large sample and record their activities. Coders also recorded organizations' *primary* activities, enabling us to segment our analysis of the CED sector according to *agency types* (developers, managers, lenders, planning and organizing organizations, and social services organizations).

The original cohort includes 5,702 CED organizations. The new segmentation file contains data on 2,225 organizations — roughly a 50 percent sample of the 4,206 organizations with websites. (The figures in this report, therefore, are weighted to represent all 4,206 organizations, excepting those where information is missing or not applicable.) Our financial health scoring covers 3,248 CED organizations, reflecting the loss of cases resulting from incomplete IRS information for all years. Because organizations without websites tend to be very small, this analysis necessarily ignores the least active organizations in the sector.

---

[4] As noted above, the research team did not make special efforts to include lenders, such as certified Community Development Financial Institutions, but if these types of organizations were found on the lists we assembled, they were not excluded from analysis.

[5] A detailed description of our list construction method appears in the Urban Institute's Technical Appendix to their study of financial characteristics of these CED organizations.

PNC BANK
COMMUNITY OPPORTUNITY ALLIANCE
UNTIL ALL THRIVE
NeighborWorks® AMERICA

COMMUNITY OPPORTUNITY ALLIANCE

1660 L Street NW, Suite 306 | Washington, DC 20036 | United States | 202-518-2660