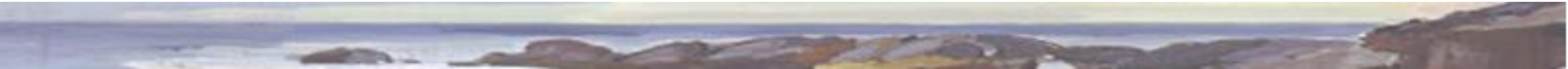
The Outlook for Nonprofit Financial Sustainability in the COVID-19 Crisis

Harpswell Capital Advisors, LLC

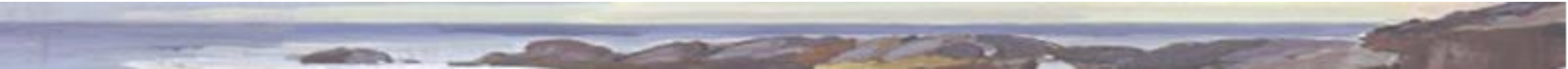
Fall 2020



Harpswell is a boutique investment firm dedicated to serving nonprofit institutions. The firm was created with a strong philosophy of striving for excellence all while embracing goals that extend beyond a one-dimensional financial scorecard. Our civic responsibility goes hand-in-hand with our focus on performance.

“ Harpswell believes the keys to investment success are as rooted in work ethic and character as they are in experience and knowledge”

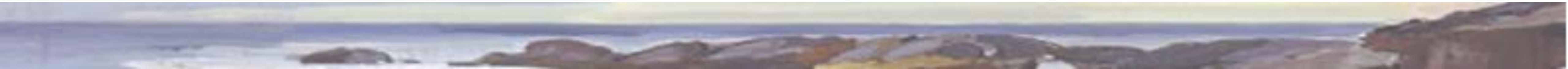
- Jack Moore, Harpswell Managing Partner



We can’t say exactly how or when the COVID-19 crisis will be resolved. It’s a devastating illness for so many people, and we hope it will be defeated soon.

Economic fallout from the crisis will be ongoing for several years. The expense incurred is already beyond reckoning. But what can any of us do about that?

In this report we look at how economic crisis affects nonprofits, and what steps can be taken now to help them weather the uncertainty ahead. To begin, let’s take a walk down memory lane, and revisit the aftermath of the 2008 Financial Crisis.



Nonprofits dependent on donations from the public were hit hard in the last recession.

The Chronicle of Philanthropy reported a significant drop in donations in 2009...

"Donations to the nation's biggest charities dropped 11 percent last year, a decline that was the worst in the two decades... The median amount raised by charities on the Philanthropy 400 also declined last year to $98.8-million, down from $105-million in 2008."

especially in stock gifts (because donors had no capital gains to offset)...

"Giving to United Way Worldwide (No. 1) decreased by 4.5 percent and to the Salvation Army (No. 2) by 8.4 percent, the smallest declines among the top-ranking groups. Food for the Poor (No. 5) saw contributions fall by more than 27 percent, while donations to the Fidelity Charitable Gift Fund (No. 6) plunged by 40.3 percent, largely because it relies heavily on stock gifts, which were not very popular last year. Also reporting declines were the American Cancer Society (No. 7), where giving fell by 11 percent, and the Y (No. 10), which reported a 17.2-percent drop in donations.

and this was accompanied by an increased tendency to donate goods instead of cash.

"Only four charities in the top 10 reported increased contributions last year. They were Catholic Charities USA (No. 9) with a 5.2-percent jump in donations; the AmeriCares Foundation (No. 3), which achieved an 18.1-percent rise in giving, mostly in food, medicine, and other donated goods; Feed the Children (No. 4), another charity that relies on donated products, where contributions rose by 1.2 percent; and World Vision (No. 8), which reported a 4.5-percent increase in giving mostly by donors who make monthly gifts to "sponsor" needy children overseas."

THE CHRONICLE OF
PHILANTHROPY

NEWS AND ANALYSIS

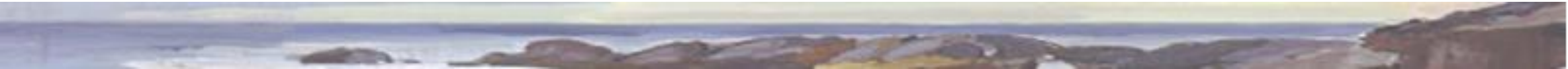
OCTOBER 17, 2010

Donations Dropped 11% at Nation's Biggest Charities Last Year

By Noelle Barton and Holly Hall

M. T. HARMON/CORPORATION FOR NATIONAL AND COMMUNITY SERVICE

Habitat for Humanity International (No. 11) builds a house in New Orleans



Were endowments an adequate “rainy day fund” when the whole economy was suffering?

Like many nonprofits, The Oregon Health & Science University suffered a loss to its endowment in 2008...

“… After the recent financial market plunges, it is now looking at a $23 million investment loss -- a revenue reversal of $42 million from budget projections. One of the largest sources of that income is OHSU's endowment, which has seen a drop in value of more than $100 million, or 24 percent, since the beginning of 2008."

which combined with reduced revenue…

"... OHSU relies heavily on clinical profits to subsidize its research and education missions. So far this year, patient volumes are only up 1.2 percent, well below a projected increase of 6 percent."

and reduced government funding…

"OHSU saw its research funding from the National Institutes of Health decline by 4.1 percent, to $193 million, last year."

to result in cuts to salaries and benefits.

"...the university has instituted a hiring and salary freeze and is planning an unspecified number of layoffs and possible benefit reductions... Because salaries and benefits make up 65 percent of OHSU's variable expenses, Robertson said it wouldn't be possible to make up the revenue gap without reducing the work force."

OREGONLIVE
The Oregonian

Business

Updated: OHSU freezes salaries, plans layoffs

Updated Mar 27, 2019; Posted Dec 01, 2008

By Robbie DiMesio | The Oregonian/OregonLive

Endowment drawdowns of 20 - 30 % were common across large and small institutions.

Similar stories played out for nonprofits across the country…

"…Dowling said the Guthrie would reduce its $28 million budget by 14 percent — about $4 million — for the fiscal year that begins April 1. Those savings would come from senior-management pay cuts, a weeklong furlough for the theater's nonunion employees, some layoffs … The theater has a full-time payroll of about 150 and seasonal employment that can double that number."

With several repeating themes…

"The budget cutbacks are necessary, Dowling said, because the value of the theater's endowment has plummeted by about 30 percent since last summer and because the theater anticipates fewer donations and less box office revenue for the coming fiscal year."

Endowments were (naturally) exposed to the capital markets,

Revenues often came from discretionary consumer spending,

Donations fell as households tightened their belts,

and (eventually) Governments found out about their own budget shortfalls…

TwinCities.com PIONEER PRESS

Guthrie Theater to cut jobs, salaries to slice $4M from budget

By **DOMINIC P. PAPATOLA**

PUBLISHED: March 25, 2009

Some lawmakers withdrew grants or made them contingent on salary caps...

The New York Times

Lawmakers Seeking Cuts Look at Nonprofit Salaries

By Stephanie Strom

July 26, 2010

Roxanne Spillett, the chief executive of Boys & Girls Clubs, was paid $988,591 in 2008. Joyce Dopkeen for The New York Times

"State and federal officials are starting to take their knives to the pay of leaders of nonprofit groups they do business with to help share the pain of tighter budgets."

ST. LOUIS POST-DISPATCH

Nonprofit hospitals' huge tax breaks under increasing scrutiny

BY JIM DOYLE • Oct 23, 2011

"...the tax-exempt status of nonprofits has come under increased scrutiny by federal and state authorities who are investigating the ever-blurrier dividing line between businesses and charities. The Internal Revenue Service is requiring hospitals to provide more specific data about their charity care, community benefits, investments and executive compensation. And some state regulators are scrutinizing the property tax exemptions granted to nonprofit hospitals."

And some cities used the threat of tax legislation to extract “voluntary” payments from nonprofits.

“In an effort to close a $110 million budget deficit, Providence mayor Angel Taveras has unveiled a plan to ask tax-exempt hospitals, colleges, and universities to make regular voluntary payments to the city in lieu of taxes, the Providence Journal reports.”

“...more than 115 municipalities in at least eighteen states, including Philadelphia, Baltimore, and Pittsburgh, collect payments in lieu of taxes from nonprofits, said Daphne Kenyon, co-author of a recent report by the Massachusetts-based Lincoln Institute of Land Policy.”

CBS Boston

Boston Task Force Asks Nonprofits To Pay Up

December 22, 2010 at 9:25 am

PND by Candid.

Providence Considers Asking Some Nonprofits for PILOT Payments

May 11, 2011

Meanwhile, some art museums resorted to "deaccessioning" (selling artwork to private collectors) in order to fund their operating costs.

The New York Times

Branded a Pariah, the National Academy Is Struggling to Survive

By Robin Pogrebin

Dec. 22, 2008

Sanford Robinson Gifford's "Mount Mansfield, Vermont," was one of two paintings the National Academy Museum recently sold. National Academy Museum and School of Fine Arts

The New York Times

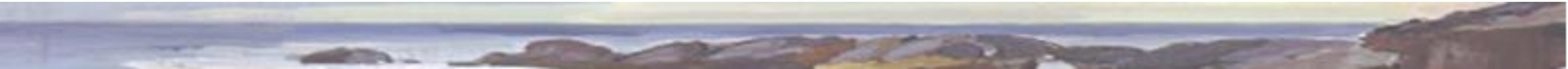
Museums and Lawmakers Mull Sales of Art

Assemblyman Richard L. Brodsky, second from left, led a hearing to review the issue of deaccessioning on Thursday. Robert Caplin for The New York Times

By Robin Pogrebin

Jan. 14, 2010

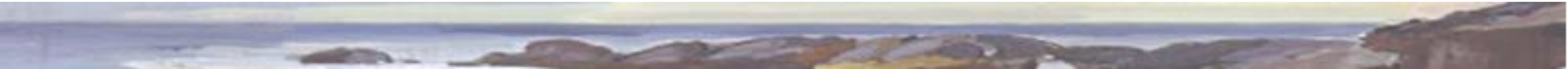
"The discussion has noted a number of recent cases, <u>including the National Academy Museum's sale in 2008 of two Hudson River School paintings to cover operating costs</u> and Brandeis University's announcement last year that <u>it would close its Rose Art Museum in Waltham, Mass., and sell the collection because of its declining endowment</u>, a plan that the university has since reconsidered."



Clearly, the 2008 financial crisis cast a long shadow over nonprofits, as it did for families and communities across the country.

Although the COVID-19 Pandemic comes with very different challenges, it brings up the same question:

How can nonprofits avoid becoming financially impaired at time when they are most needed to serve their community and their mission?



Harpswell CAPITAL ADVISORS, LLC

Repeatedly, after the last crisis, these four factors of financial sustainability came into play:

Endowment Income

How much beta is in the portfolio? What is the liquidity buffer?

Revenue from Operations

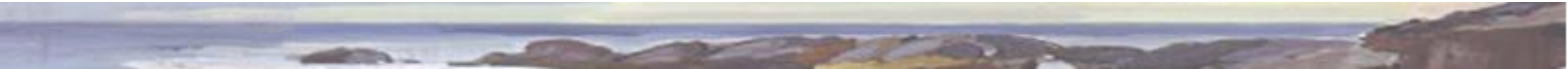
What are the revenue sources? What idosyncratic risks do they face?

Philanthropic Gifts

How dependent is the nonprofit on ongoing donations?

Government Grants

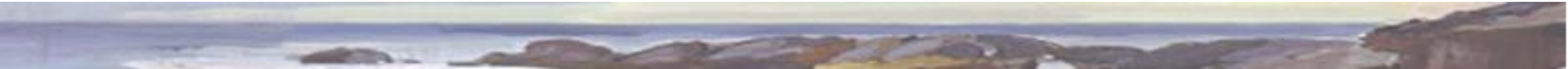
Will there be a second squeeze when governments get around to cutting costs?



The purpose of Harpswell’s COVID-19 outlook for nonprofits isn’t to instill a sense of dread. We want to spread the message we’ve been emphasizing with our clients and colleagues in our nonprofit network.

Don't take the rebound in the financial markets for granted and continue with business as usual. Consider this a momentary reprieve from volatility.

Take this time to evaluate how the four factors of financial sustainability (endowment earnings, revenues, philanthropy, and government spending) affect your nonprofit.



Most importantly, take the following steps to make sure your investment policies are aligned to serve your investment needs in any market.

1. Role of the Endowment

Establish the endowment's role with respect to your institution's mission and align your investment policy statement (IPS) accordingly. The most common source of anxiety for nonprofits during periods of heightened market volatility stems from a misalignment between investment policies and the role of the endowment.

2. Goals & Time Horizon

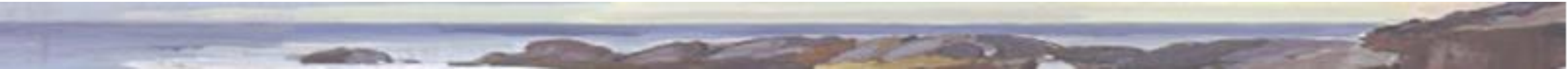
Define your endowment goals to set appropriate time-horizons. Is your endowment a source of perpetual support, a rainy-day fund or a means to fund future growth? Whatever the combination of goals you have established defines your time horizon--the key consideration in codifying your IPS.

3. Risk Tolerance

Invest based on your established goals. For long-term goals, you can afford to weather downturns and be positioned more aggressively (e.g., more equities than bonds). For nearer-term needs, more conservative positioning is preferred as prospects of recovering from a sudden sell-off are reduced. Further, if you will need to pull funds during market downturns, a more conservatively positioned portfolio is indicated.

4. Liquidity Needs

Consider your potential cash needs. Institutions with less capacity to weather financial stress need to have an IPS which can yield distributions during downturns. Conversely, an entirely different set of policies should govern institutions that can forgo payouts during downturns.



Beyond the strategic assessment we recommend above, there are a few items that can be acted on promptly (the sooner the better!)

First, assess your needs and take advantage of the market bounce(s) to raise cash from the portfolio (if warranted). Remaining mindful of restricted funds, taking action to avoid a cash emergency can outweigh the opportunity costs of not being fully invested.

Second, take advantage of the recent turmoil to determine if the endowment is managed according to your expectations. Down markets reveal the poor strategies and expose who might have been taking too much risk. As Warren Buffett says, “you can see who is swimming without a bathing suit when the tide goes out.” Consider whether a specialized endowment-advisor might benefit your institution.

Third, talk with your endowment advisor and ask questions. At Harpswell, we know that sound communication is a key for successful long-term partnerships and becomes even more crucial in times of crisis. At the height of the volatility, we relied on the updates from the nonprofits we serve for tactical positioning. If you have not heard from your advisor, reach out and propose a Zoom meeting!

Fourth, take stock of your endowment framework and determine if you need to make changes. Is your IPS updated and does it reflect your goals? Is the endowment sustainable and able to deliver what you need?

Finally, be guided by some basic “do’s” and “don’ts”:

Do’s

• Stick to the plan – don’t act with emotion.
• Minimize risks from cash crunches.
• Know your endowment’s characteristics—know what it would have done in other volatile time periods so you can anticipate how it should perform under future scenarios.

Don’ts

• De-risk after the damage is done (instead, plan in calm times).
• Take out more cash without planning.
• Panic (trust your endowment advisor).
• Monday morning quarterback in the short term.
• Miss the opportunity for a post-mortem. Downturns can provide clarity on whether your endowment is aligned with your mission.

Harpswell
CAPITAL ADVISORS, LLC

In closing,

Harpswell Capital Advisors is a boutique investment firm dedicated to serving not-for-profits throughout the United States. Harpswell is structured as an Outsourced Chief Investment Office (OCIO) embracing the same approach to investments as larger college and university endowments office.

The firm was founded with a civic mission to further the impact of the institutions we serve. We are laser focused on the specific needs of non- profits and our fee levels reinforce Harpswell’s unwavering commitment.

Please reach out if you would like to discuss what’s on your mind or learn more about Harpswell Capital.

Call: 877.427.7227 **email: info@harpswelladvisors.com**

www.harpswelladvisors.com

Harpswell Capital Advisors Named to investor.com's 2020 list of Top Charitable Financial Advisor Firms in the Nation!

"Harpswell is dedicated to serving not-for-profit institutions and our team is honored to receive this recognition."

-Jack Moore, Managing Partner

Only 108 firms in the nation were named to the 2020 list and Harpswell is the only firm in the state of Maine to be recognized.

In order to determine the 2020 Top Charitable Financial Advisor Firms, investor.com's research team analyzed data from more than 7,000 RIAs and applied the following qualifiers:

- The firm must be Trusted by investor.com according to the [Trust Algorithm].
- The firm must have a clean disciplinary history.
- The firm must have at least 10% or greater of their total client base with charitable organizations.
- The firm must have at least 10% or greater of their total AUM with charitable organizations.

Disclosure

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Harpswell invests in stocks, bonds, mutual funds and sometimes alternative investments. Each asset class, along with each individual investment, carries varied degrees of risk of loss. Harpswell analyses investments from a long-term fundamental perspective and aims to engineer portfolios that have an attractive risk and reward balance. Despite a strong bias for diversification, all Harpswell portfolios do carry risks of losses, particularly in times of escalated market volatility. Harpswell does focus on capital preservation yet extraordinary markets can potentially generate material losses.

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Alternative investments are designed only for sophisticated investors who are able to bear the economic risk of losing all of their investment. Alternative investments: (1) often engage in leveraging and other speculative investment practices that may increase the risk of investment loss; (2) can be highly illiquid; (3) are not required to provide periodic pricing or valuation information to investors; (4) may involve complex tax structures and delays in distributing important tax information; (5) are not subject to the same regulatory requirements as mutual funds; and (6) often charge high fees.

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Index Definitions
The S&P 500 Stock Index is an unmanaged market capitalization index of 500 US equities generally considered to be representative of US stock market activity. The Morgan Stanley Capital International World Index is a market capitalization-weighted equity index of over 1,500 stocks traded in 22 world markets. The NASDAQ Composite Index measures all NASDAQ domestic and non-U.S. based common stocks listed on the NASDAQ Stock Market. The Index is market value-weighted. The SB World Bond Index is a market capitalization weighted index of 18 Government bond markets composed of sovereign debt denominated in the domestic currency. The Lehman Aggregate Index is a benchmark index made up of the Lehman Brothers. The Hennessee Hedge Fund Indices® are calculated from performance data obtained from publicly available information, internally developed data and other third party sources believed to be reliable. MSCI EAFE is a stock market index that is commonly used as a benchmark for the performance of major international equity markets. The MSCI Emerging Market Index is an index created by Morgan Stanley Capital International (MSCI) that is designed to measure equity market performance in global emerging markets. The Russell 1000 seeks to track the investment results of an index composed of large- and mid-capitalization U.S. equities. The Russell 2000 seeks to track the investment results of an index composed of small-capitalization U.S. equities. The Russell 2500™ Index measures the performance of the small to mid-cap segment of the U.S. equity universe, commonly referred to as "smid" cap. The Barclays Capital Global Aggregate Bond Index is designed to be a broad based measure of the global investment-grade, fixed rate, fixed income corporate markets outside the United States. The Barclays Capital US Gov/Credit bond Index measures the performance of U.S. Dollar denominated U.S. Treasuries, government-related and investment grade U.S. corporate securities that have a remaining maturity of greater than one year.

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