

Crunch Time

A growing number of charities are scrambling to make ends meet as lines of credit dry up and disappear

By Debra E. Blum

A GROUP that serves adults with mental disabilities in California is rushing to find a new lender after a financial-services company abruptly pulled a line of credit that the charity taps monthly to pay salaries until state grant money arrives.

An arts organization in the Northeast has been forced to sell investments at fire-sale prices to pay a line of credit that has shrunk precipitously along with the value of the equities the group uses as collateral for the loan.

And a New York City charter school and after-school program has, for the first time ever, drawn money from its credit lines so it will have cash in the bank in case donations drop this year and less credit is available.

A Bailout for Charities?

Those charities and plenty of others across the country are feeling the effects of the tightening credit markets that have been a hallmark of the nation's recent economic downturn. Banks are pulling or restricting lines of credit, hurting the businesses and nonprofit organizations that rely on the short-term cash loans to pay for operating expenses.

The situation has been aggravated by the budget shortfalls facing many state governments. Some have responded by delaying payments to nonprofit groups that have performed social services under government contracts.

Independent Sector, the coalition of charities and foundations in Washington, has become so alarmed by the stories it has heard about the credit problems that it has asked Congress to create a \$15-billion federal bridge-loan fund for charities as part of its economic-stimulus plan.

The money would help the organizations provide the services that government has asked them to do, says Diana Aviv, president of Independent Sector. "These agencies are the instruments through which government fulfills its obligations to its citizenry."

Financial experts predict even more charities will take a hit in the coming months.

"I expect a tidal wave of desperate nonprofits in the next six months," says Dutch R. Haarsman, senior vice president of the Northern California Community Loan Fund, a nonprofit lender. "As lines of credit are termed down, they will not be renewed, and some will be termed out

with outstanding balances that nonprofits won't be able to pay."

Credit scarcity by itself would be worrisome to many nonprofit organizations, says Robert J. Yetman, who studies nonprofit finance at the University of California at Davis, but coupled with the other effects of the melting economy, such as declining donations, the impact may be devastating.

"It's the compounding factor," he says. "You have nonprofits that might not be able to pay their bills because money isn't coming in, so they need credit now more than ever before, but it's harder to get credit now than before because the market is so tough and banks are worried that these groups won't have the cash to pay them back."

At least six out of 10 American charities regularly rely on some sort of credit, according to Mr. Yetman's analysis of Internal Revenue Service data. That includes all kinds of debt, like mortgages and long-term loans for building projects.

Common, too, are lines of credit, an arrangement in which a bank or other kind of lender makes a specified amount of money available to a borrower, who can draw from that pot as needed, paying back the money with interest in a limited period of time. As the borrower pays back the principal, that amount becomes available to borrow again.

Many charities rely on credit lines to help them manage their cash flow as they wait for grants and government-contract money to come in, or for donor pledges to be paid. Others use money from credit lines to smooth out seasonal fluctuations in their revenue. A theater group, for example, might borrow money during months with no performances, and pay it back as ticket sales for forthcoming shows roll in.

Pacific Diversified Services, the California group that works with mentally disabled adults, gets 85 percent of its annual budget of about \$650,000 through state contracts. But the government pays in arrears, meaning that Pacific doesn't get paid until the middle of the month after the one in which the services are provided.

To make up for the temporary shortfalls, Pacific draws from a line of credit to meet its second payroll of the month, then pays the money back immediately after it gets the government grant.

In November, though, the organization was notified by American Express that the

company was closing Pacific's \$33,000 credit line as of mid-January.

An American Express spokesman, Thomas M. Sclafini, says that the company is abolishing its entire line-of-credit business, closing all its clients' accounts.

"The decision has nothing to do with any one individual account," he says.

Nonetheless, the decision hit home for Pacific, says its founder and executive director, Lisa M. Giraldi.

"I'm not a pizza-parlor owner who doesn't know how many

"Maybe this shake-up will eventually knock sense into lenders who will see that nonprofits are actually pretty secure bets."

pizzas I am going to sell next month," Ms. Giraldi says. "We have a government contract that has been stable for 19 years. We are not operating in the red because we have the equity of a whole month's costs coming to us from the state."

Ms. Giraldi has several applications out for new lines of credit, and has held an emergency fund-raising drive—which reaped \$40,000—to tide the organization over until it is able to borrow again.

Feeling the Squeeze

While Pacific lost its entire credit line, many charities in recent months have faced squeezes as their credit lines are—reduced by jittery bankers or jeopardized by changing economic conditions.

The arts organization in the Northeast, which declined to be named, was forced to quickly pay back money it had borrowed from its credit line when the value of its investment portfolio plunged. According to its loan agreement, the organization could borrow no more than the value of one-half of its assets. When stock-market losses led to a 40-percent decrease in the organization's assets recently, it was suddenly overdrawn on its credit line. The ratio was fur-

ther stressed when the organization had to sell stock to raise the cash to bring the size of its debt down below the 50-percent mark.

"With wild swings—mostly dips—in the economy these days, you could be in compliance with your loan terms one day and out the next," says Ron Mattocks, a consultant and author of a book about nonprofit groups facing financial distress. He says credit lines that are based on the value of organizations' property holdings are also suffering, as real-estate prices fall in many markets around the country. And lenders, worried about borrowers' ability to pay their debts, may be toughening loan terms or making it more expensive to borrow.

A social-services group in the Albany, N.Y., area had a 1-percent annual maintenance fee tacked on a bank-operated credit line it had had for a number of years without such a cost. In response, the group closed its account, opening a new line of credit at the Capital District Community Loan Fund, a nonprofit lender in the city that does not charge the annual fee.

Testing Credit Lines

Even at charities that have not yet had their credit lines scratched, reduced, or altered, preparations may be under way to weather a possible credit crunch.

"We wanted to test our lines," says Robert Berlin, chief executive at Harlem RBI, the New York school and youth program, referring to the organization's decision this fall to tap its credit for the first time.

The \$7-million-a-year organization is feeling the pinch of declining foundation grants—down 20 percent so far this year—and wants to make sure it can keep up its cash reserves, which usually represent three to six months' operating expenses. By next month, it will have \$350,000 out on two credit lines.

"We're pulling money to beef up operating reserves," Mr. Berlin says. "It's worth it for us to eat the difference between the 3 percent we are making in the money market account and the 4 to 5 percent we are paying in interest. We feel better having that money in our bank account and not worrying if we'd be able to access it if something traumatic occurred, like one large grant disappearing or one big cut in city funds."

Extra help, though, may be on the way if Independent Sector can get the federal government to create a bridge-loan

fund for charities with cash-flow problems due to delayed government payments. It has suggested that the fund be operated by a federal administrator who would be located in an existing federal agency or in a new body modeled after New York's September 11th Victim Compensation Fund.

Some nonprofit lenders and foundations also are considering ways to make more money available to charities facing difficulty getting or keeping their credit lines.

The Capital District Community Loan Fund, which lends to nonprofit groups and small businesses money raised from low-interest loans, grants, and donations, plans to increase its loan pool by \$1-million this year, to \$9-million.

The Marin Community Foundation, in California, and FJC, a New York foundation that manages donor-advised funds, are among the grant makers around the country with loan funds that are considering increasing their lending dollars or the number of charities that can set up credit lines.

Margery E. Ames, executive director of the InterAgency Council of Mental Retardation and Developmental Disabilities Agencies, in New York, says the credit crunch may have a silver lining. "Maybe the good things that come out of this are that more foundations make loan funds available and commercial lenders that are changing their criteria finally see that there should be different criteria for nonprofits."

She says, for example, that social-service groups working on government contracts should not have to show the same kind of profitability expected from small businesses.

"There are borrowing covenants, like having to pay down your line to zero for at least 30 days each year, or showing profits even when you are set up to break even so you qualify for government funding, that just don't make sense," Ms. Ames says. "Maybe this shake-up will eventually knock sense into lenders who will see that nonprofits are actually pretty secure bets."

Mr. Mattocks, the consultant, also hopes the credit crunch will have a positive outcome: Charities thinking harder about their overall fiscal plans.

"The economy is proving how vulnerable everyone is," he says. "Debt makes you even more vulnerable, and so once we get through the crisis it will be time to ask the hard questions about what it means to borrow."