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Program Preservation, Evolution, and Financial Change: Finances and Fundraising: Accessing Cash

Uncertain economic times in the wake of the COVID-19 pandemic and fiscally challenging conditions may have left many nonprofits feeling strapped for cash. Even nonprofits with sufficient reserves or solid revenues may experience difficulties with cash flow from time to time and for many reasons, including delayed or deferred government contracts or grants, unusual one-time expenses, or restrictions on the use or management of certain funds. This legal alert will explore several ways nonprofits can access funds and get cash flowing again.

Borrow Funds

One way for nonprofits to access cash is to borrow funds from a financial institution, such as a bank, a credit union, a lending nonprofit organization, or from an individual lender. Loans can provide organizations with funds to manage daily operations and help fill gaps in the organization's financial future, until it is able to access other money to pay back the loan.

Nonprofits may want to consider the following questions before entering into a loan:

- Do you have the financial resources to make monthly payments?
- Do you have a budget in place to manage your finances moving forward?
- Are interest rates low?
- What is the organization's current financial situation?
- What assets can the organization provide as collateral?

Ensuring a nonprofit is able to take on a loan is the best way to avoid defaulting on a loan, which can have serious consequences for a borrowing nonprofit. In addition to affecting the organization's credit history, default may enable the lender to take action against the organization, including refusing to extend additional credit, demanding immediate repayment of the debt, taking possession of any collateral, and collecting the debt from any guarantors. Nonprofits should try to negotiate amendments to the loan with the lender in order to avoid default.

Nonprofits can also consider borrowing from an individual lender. These types of loans can be advantageous as an individual lender can decide to charge a lower interest rate than a financial institution. Also, an individual lender may decide to forgive the loan and claim a tax-deductible contribution. Individual lenders can be an employee, director, officer, or significant funder of the organization. If a board member or employee is a lender, the board of directors should review the loan to ensure compliance with conflict of interest and personnel policies. The terms of the loan should also be considered, as it is not in the organization's best interest to accept less favorable terms than would be available from an unrelated third party, like a financial institution.

Refinancing a Loan

Refinancing can benefit nonprofits by providing an opportunity to make lower payments on an existing loan, thereby freeing up additional cash. Nonprofits considering refinancing a loan should try to negotiate for lower interest rates or a shorter or longer payment period. However, be aware that refinancing may simply defer serious financial problems without resolving them, as better loan terms may come at a cost of pledging additional collateral or paying more interest over the loan period.

Tap Endowment Funds and Other Restricted Gifts

Gifts from donors may be restricted to certain uses. These restrictions can be found in the language of the gift solicitation language, funding agreement, or donor's writing accompanying the gift. Even gifts received without specific restrictions generally must be used for the organization's stated charitable purposes. A nonprofit's board of directors is required by the New York Not-for-Profit Corporation Law to ensure that donated assets are used according to their specified purposes. In order to comply with this requirement, all accounting books should distinguish between funds received under a particular grant or contract and those generally available for expenditure. Additionally, nonprofits may be required to keep certain funds in separate bank accounts. Modifying or removing a donor restriction requires written consent from the donor or court approval.

Endowments are a specific type of restricted gift. Endowment funds are not wholly expendable on a current basis under the terms of the gift instrument. The principal must continue in perpetuity, but nonprofits can use the income and appreciated value from the gift, and sometimes the appreciation. Where a board has the power to spend all of the funds but affirmatively chooses not to, these are "board designated" funds rather than endowment funds.

During an economic downtown, endowment funds may become "underwater," i.e., the current value is less than the value at the time of the gift. Since 2010, the New York Prudent Management of Institutional Funds Act ("NYPMIFA") has allowed nonprofits to appropriate and expend endowment funds below the "historic dollar value" of endowment gifts, if the board determines in good faith that the expenditure is prudent and consistent with the purpose for which the fund was created.

Explore Fee-Generating Activities

Charging for goods and services may provide another source of cash. It is generally permissible and not uncommon for nonprofits to generate revenue through fees. Common fee structures include flat fees, waivers and discounts for certain situations, and sliding scales. Nonprofits wishing to charge fees should review funding contracts, funding proposals, and award letters to ensure that charging a fee for good or services is not prohibited under current or requested grants.

The revenue generated from charging fees may be subject to Unrelated Business Income Tax ("UBIT").[1] While fee-generating activity which is related to the organization's charitable purposes is usually not taxable under UBIT, other aspects of the UBIT rules may apply. UBIT obligations should be considered

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[1] See https://www.lawyersalliance.org/userFiles/uploads/legal_alerts/Basics_of_the_Federal_Unrelated_Business_Income_Tax_on_Nonprofits_Legal_Alert.pdf.

but generally do not impact tax-exempt status unless the fee-generating activities represent a substantial part of the organization's focus.

Lines of Credit

A line of credit provides a limited amount of funds that can be borrowed from a bank or other financial institution. Akin to a credit card, the funds can be used at any time until the limit is reached. The limit is set by the issuer based on a borrower's creditworthiness and as the money is repaid, it can be borrowed again. The amount of interest, size of payments, and other rules are set by the issuer. A line of credit can provide access to money for unforeseen business expenses, and nonprofits commonly use them for emergencies, payroll, or covering delayed reimbursements.

To qualify for a bank-issued line of credit, nonprofits must often provide collateral, personal guarantees, and detailed financial records. A strong relationship with the bank or a stable financial history can improve approval chances. However, some banks may tighten their creditworthiness requirements during economic downturns. Alternative lenders, which use private funds and are less regulated, have become popular due to their flexibility and willingness to work with smaller organizations. These lenders filled a significant gap left by traditional banks during the 2008 recession and now facilitate most small business and nonprofit loans.

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This Legal Alert serves as guidance for nonprofits considering their options with respect to accessing cash. If you would like assistance with questions about loans, endowments, restricted gifts, or fee-generating activities, please contact Lawyers Alliance.

This Alert is meant to provide general information only, not legal advice. If you have any questions about this Alert please contact Lori Moses at lmoses@lawyersalliance.org or visit our website at www.lawyersalliance.org for further information. To become a client, visit www.lawyersalliance.org/becoming-a-client.

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