Nonprofit Finance Fund®

Canal Alliance & NFF
Summary of Partnership
As of November 25, 2020

Overview

The purpose of this memo is to summarize the work Canal Alliance and Nonprofit Finance Fund (NFF) have achieved to date as we have considered the financial implications of Canal Alliance's expanded work in affordable housing. This memo should be read in conjunction with the following documents:

- "Canal Community Vision Project 2019"
- "Canal Alliance FSA 2019 – Final for 2.26.2020 presentation"
- "Canal Alliance Projections_8-26-2020 Board Update"

From initial conversations with Canal Alliance leadership, we understood that Canal Alliance exists to break the generational cycle of poverty for Latino immigrants and their families by lifting barriers to success. In partnership with Dominican University and the Data Center, Canal Alliance developed a community-led vision for healthy development and saw an opportunity to serve as a leader in ensuring housing that is truly affordable for residents of the Canal neighborhood.

Canal Alliance leadership recognized that expanding the organization's work in affordable housing would significantly change its business model and wanted to better understand the implications of this decision as well as strategies for responsibly leveraging debt financing while maintaining a healthy and resilient capital structure. Therefore, we developed a scope of work intended to:

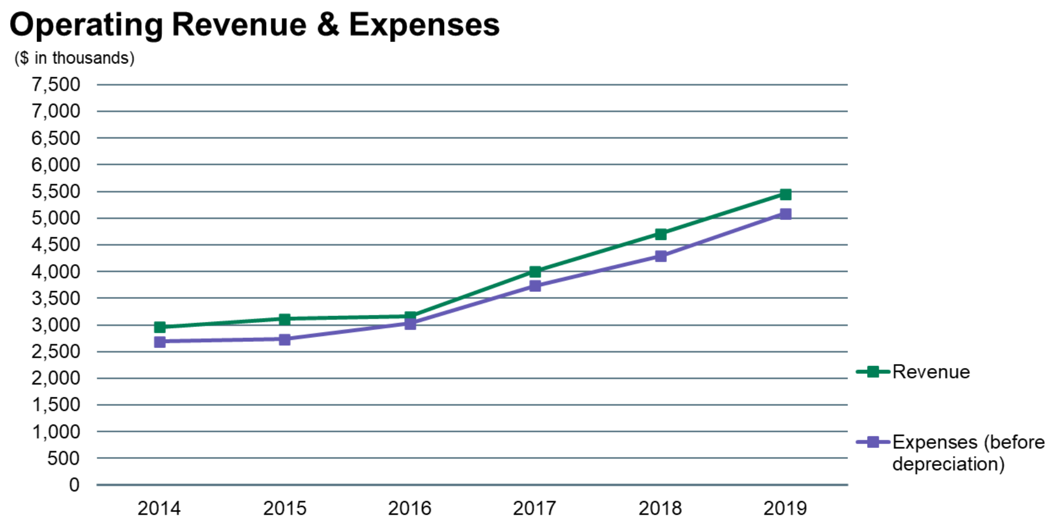
- Provide a foundational understanding of Canal Alliance's historical financial performance, its current financial situation, and its future trajectory;
- Prepare leadership for planned growth, with considerations grounded in the implications for the organization's business model and effects on programs; and
- Explore considerations for responsible debt management through capitalization and growth planning.

Enterprise-wide Financial Diagnostic

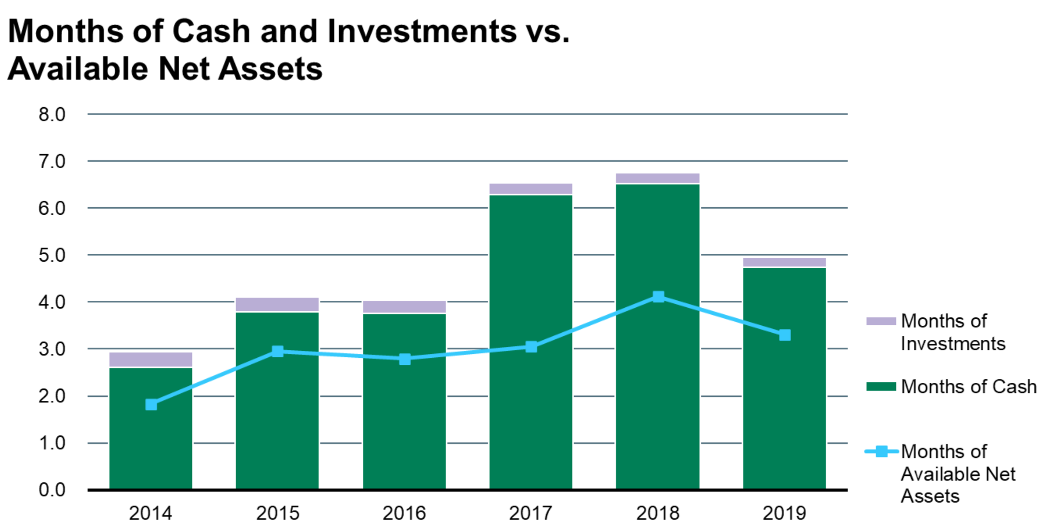
Our work began with a robust financial diagnostic of Canal Alliance's comprehensive financial health – including its historical business model and capital structure. Our analysis used information derived from audited financial statements for FY2014-2019. Our goal was for NFF and Canal Alliance leadership to develop a full and common understanding of the organization's business model performance and capital structure health, and therefore, its readiness for exploring expanded affordable housing work.

In examining profitability and savings, revenue dynamics, and expense dynamics, we found Canal Alliance to have a strong business model that produced pre-depreciation operating surpluses ranging between 4-14% of expenses over the six years of financial data analyzed. These surpluses have been achieved during a period of significant growth in operating revenue, which has increased from $2.96 million in FY2014 to $5.45 million in

FY2019. Canal Alliance's strong business model performance has been a consequence of growth in contributed revenue from foundations and individuals, which makes up on average 80% of its total operating revenue. During the period from FY2014-2019, contributed revenue grew annually at 13% on average for total growth of $2.49 million. During this same period, Canal Alliance invested in its staff – increasing personnel spending 11% annually on average – while managing expenses to revenue realities and thereby producing consistent operating surpluses.



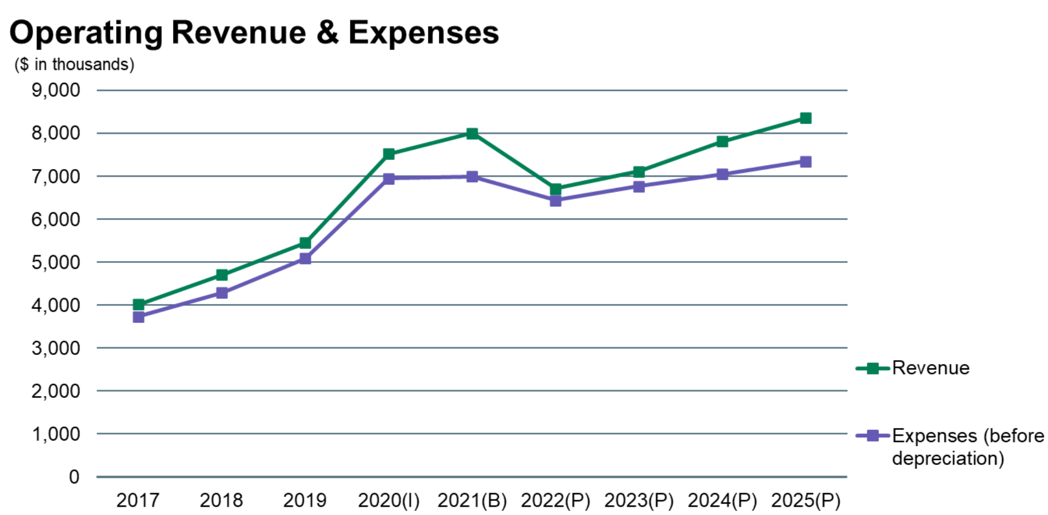
Canal Alliance's balance sheet also showed strong indicators of financial health. The organization reliably had between two and four months' worth of available net assets on hand over the six years analyzed. Management has shown its ability to manage its assets by having sufficient cash on hand, managing receipt of receivables, and investing in property and equipment. Management has also shown its ability to manage liabilities by keeping current on payables and on schedule with property-related debt.



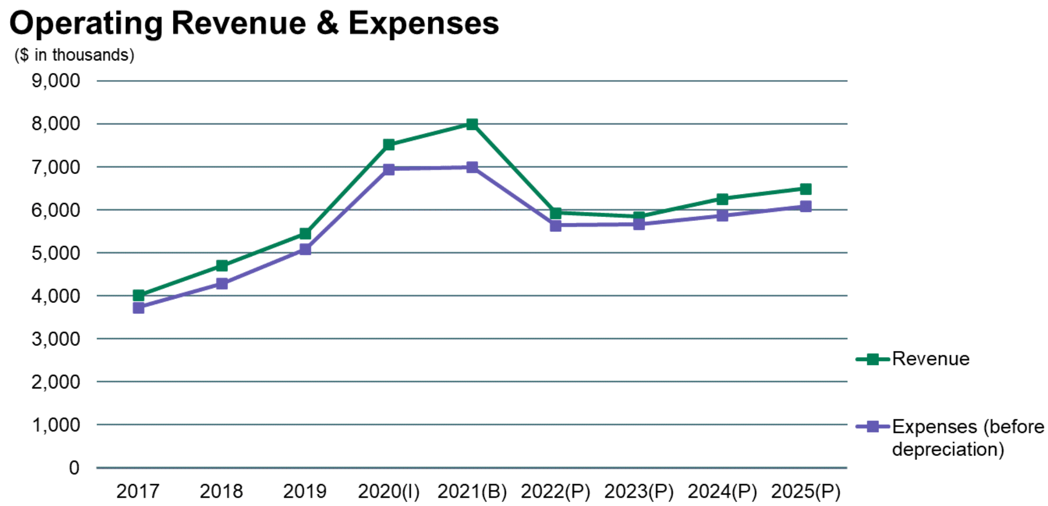
It is because of these financial trends, as well as management's commitment to continuing existing financial management practices, that we shared with Canal Alliance senior staff (on January 27, 2020) and Canal Alliance Board of Directors (on February 26, 2020) our opinion that the organization has a business model and capital structure that allows for adaptation and innovation – in this case, the exploration of expanding its affordable housing work.

Business Model Projections

After the historical financial situation analysis, we turned our attention to a forward-looking exercise in order to gain visibility into the potential future performance of existing programs. Together we examined key drivers of Canal Alliance's business model and discussed risks and opportunities for each program, revenue, and expense. This exercise provided insight into the possible upside growth and downside risk of revenues, as well as management's expense decision responses to the different revenue scenarios. Specifically, we modeled what investment in staff and other expenses would be required to meet potential revenue growth; we also modeled the expense levers available to management if revenue realities were more in-line with a downside scenario. With this information in hand, we were able to produce a range of likely outcomes for the organization's current business model in both the upside scenario for the projection:



As well as the downside scenario for the projection:



In the upside range of this projection, we see pre-depreciation operating surpluses for FY2022-FY2025 ranging from 4-14% and in-line with the organization's historical surplus levels. In the downside range of this projection, pre-depreciation operating surpluses were forecasted between 3-7%. This exercise gave us confidence that Canal Alliance management is ready with specific expense responses to different revenue scenarios, allowing the organization to project ongoing operating surpluses over the next five years. As a result of such surpluses, our balance sheet projection showed the forecasted capital structure as able to continue to support the organization's business model with between three and seven months' worth of available net assets on hand over the projected period.

We shared this information with Canal Alliance's Board of Directors on August 26, 2020. During the meeting we expressed that although the forecasting exercise gave us confidence in the organization's ability to continue to produce strong financial results, the forecasted surpluses are not sizable enough to consider "subsidizing" much, if any, of the expanded housing work. Similarly, we suggested that the balance sheet resources on hand be allocated to managing risk and adaptation for Canal Alliance's current business model and programming – and not sizable enough to make a major investment in the housing program expansion strategy without putting existing programs at risk. Therefore, we anticipate the implementation of the organization's chosen housing strategy will require philanthropic "build" capital to subsidize up-front and programmatic scaling costs.

Next Steps

We understand that Canal Alliance's housing consultant, Street Level Advisors, will soon be providing a business model and financing outline for the Board-approved housing expansion strategy. With this information, we plan to deepen and incorporate the financial assumptions into our existing projections model in order to explore questions such as:

- What are the revenue scenarios that might result from an expanded housing program?
- What will be the impact of adding additional housing program staff as well as enterprise-level staff needed to support fundraising, finance, etc. efforts as part of a larger organization?

- How much philanthropic “build” capital will be required to implement the housing strategy and over what period of time?
- What will be the capital needs for the housing strategy as well as the enterprise once the expansion takes place?
- How can we “allocate” existing balance sheet resources as well as name future capital needs in order to ensure the organization is able to continue managing risk, adapting, and pursuing new opportunities?

We look forward to continuing this work with Omar Carrera, Monica Bonny, the Canal Alliance Board of Directors, and Canal Alliance staff. Please feel free to reach out if you have any questions or need additional details regarding Canal Alliance and NFF’s work together to date.

Martin Lenarz-Geisen
Associate Director, Advisory Services
Nonprofit Finance Fund
mlenarz-geisen@nff.org

Isela Gracian
Associate Director, Advisory Services
Nonprofit Finance Fund
igracian@nff.org