BALANCING ACT: SUSTAINABLE FINANCES FOR SHARED SPACES

A STATE OF THE SHARED SPACE SECTOR SURVEY 2015 REPORT

SPONSORED BY:

THE JONES TRUST

THE NONPROFIT CENTERS | NETWORK
Introduction

During the 2015 State of the Shared Space Sector survey, NCN found that a large proportion of mission driven shared spaces are operating as successful social enterprises. Over 70% of nonprofit centers were operating at a break even or profitable financial position. At the same time, The Nonprofit Centers Network has heard from many of its members that traditional nonprofit funding streams, like major gifts or foundation grants, are difficult for them to attain. It is important to analyze the practices of the profitable centers to understand how to help those centers that are running a deficit and to help new spaces avoid major pitfalls.

For this research we sought to answer the following key questions:

• How does square footage influence a center’s profitability?
• Do differences in tenant mix and duration influence profitability?
• Are there any unexpected indicators of profitability?

Methodology

For the purpose of all of the reports generated by the 2015 State of the Shared Space Sector survey, the definition of “shared space” or “nonprofit center” is a physical facility that intentionally houses more than one nonprofit organization with a social purpose. The data for this report was gathered in January 2015, when The Nonprofit Centers Network sent an electronic survey with 86 questions to 624 either known or potential nonprofit centers. NCN maintains a database of intentionally created shared spaces that contained contact information for 393 nonprofit centers at the time of the study. 140 centers responded for a response rate of 22%. To bolster the completeness of the financial component of the survey, additional data was requested from all centers that reported their total square footage for their center. The data set was then run through a series of regression models to determine how much of the variation in profitability could be explained through the variables that were collected.

Profitability and Shared Space

During the 2015 State of the Shared Space Sector Survey, 56% of respondents reported a financial surplus between $5,000 and $2 Million. At the same time, almost a quarter of the sample is running a deficit of $15,000 or more. The remaining respondents reported a surplus or a deficit within $5,000, so this group is considered “Break Even” for the purposes of this report.

Fundraising

It is important to note that profitable centers are not simply better at fundraising than their counterparts. As many practitioners know, shared space is a challenging nonprofit mission to convince funders to support. Profitable groups have found ways to maximize their earned revenue, as fewer profitable groups report that they have to fundraise for operating costs. In contrast, two-thirds of the centers running at a loss report fundraising for operations at least once a year.

Square Footage

One of the most striking areas of difference between profitable and unprofitable shared spaces was in the size of the space.

At 67,000 square feet, the average profitable center was approximately 20,000 square feet larger than the average center running a loss. On average, break-even centers are only slightly larger than those that are running a loss. Based on statistical modeling done with the data, each additional square foot of space is associated with a $3.05 increase in net revenues.
How your center is divided between rentable and common area also matters. For the purposes of this report, common area includes anything that is not rentable, including but not limited to conference rooms, shared kitchens, hallways, rest rooms, elevators, mechanical rooms, etc. Profitable centers have a greater percentage of rentable space (66%) than those that are running at a loss (55%). A 1% increase in the rentable share of space is related to a $6,035 increase in annual net revenues.

Profitable centers have 40,000 sq. ft. of rentable square feet for every 10,000 sq. ft. of common area, where centers running a loss have 25,000 sq. ft. of rentable square feet per 10,000 sq. ft. of common area. There is not a direct correlation between size and profitability, as Break Even centers have 53,000 rentable sq. ft. per 10,000 sq. ft. of common area.

The total amount of rentable square footage is not the only factor that impacts profitability, because centers that are operating in break-even position have the highest average percent of rentable square footage at 70%.

Vacancy Rates

Nonprofit centers should be leasing their spaces to the fullest. Higher vacancy rates are associated with lower net revenues in the statistical models. For example, a 1% increase in a center’s vacancy rate is correlated with a $25,466 reduction in net revenues. Profitable spaces had an average vacancy rate of 1%, within a range of 0 to 20%. Centers operating at a loss had an average vacancy rate of 5%, within a range of 0 to 40%.

Tenancy

Having a strong, stable tenant base seems to differentiate the profitable centers from their less successful counterparts. On average, a space running a surplus has 26 tenants. Spaces that are running in the red have, on average, 15 tenants. A larger tenant base provides more stability in terms of revenues streams, because each one is a smaller percentage of the whole rental revenue than if there were only a few tenants.

Additionally, profitable centers have tenants that stay longer. The average length of tenancy at profitable centers is 5.8 years, while unprofitable centers only see their tenants stay for an average of 3.9 years. Consequently, profitable centers have an average annual turnover rate of 4%. Centers operating at a loss have an average annual turnover rate of 7%.

Looking at tenant mix through the lens of the most common types of centers – theme centers, service centers, multi-sector centers, and incubators – there was little variation. Incubators are the least profitable subset of shared spaces, which can be attributed to the amount of costs that they are subsidizing for their tenant organizations. Theme, service, and multi-sector centers were very similar in terms of profitability.
Expenses per Square Foot

One of the most striking findings was the difference in center spending between centers. In order to account for the range of sizes of centers, the total expenses required to run the building, inclusive of staff, were divided by the center’s square footage, both gross and rentable. Groups that run a profit have the lowest costs per square foot in both the total and rentable areas, averaging approximately $22 per rentable square foot. In groups running a loss, the costs per gross square foot are almost 2.5 times higher than their profitable counterparts. This issue is exacerbated by the distribution of square footage. If costs are evaluated on rentable square feet, the cost is almost 4.5 times that of profitable centers.

An important component of a center’s expense ratio is in how the center is staffed. Centers that operate at break-even employ the fewest management staff overall. The average number of management staff is about the same in both profit and loss scenarios, but those centers running at a loss have more paid part-time help. A larger full-time management staff relative to center size decreases the likelihood of generating a surplus. For example, a one-standard deviation change in full-time staff from 0.7 per 10,000 square feet to 1.5 per 10,000 square feet is associated with a reduced predicted probability of a surplus by 19.4 percentage points.

Age

Older centers are more likely to be profitable. The average age for profitable centers is 15.7 years, while the average age for those running a loss was 9.4 years. Forty-two percent of nonprofit centers running a loss have been open five years or less. A center that has been open 10 years is around 7.7 percentage points more likely to have a surplus than a center open one year.

Debt Financing

A common theory is that nonprofit centers will not be profitable if they use debt to finance their acquisition or renovation of the building. The State of the Shared Space Sector data tells a different story. Forty percent of profitable centers used debt as a part of their financing plan. Only 25% of centers running a loss used debt. Debt financing requires more fiscal rigor, and the borrower is accountable to a lender. These factors may help set spaces up for success in the future.

Maintenance Reserve

While it is unclear if having a maintenance reserve leads to profitability or vice versa, the data is clear that a majority (77%) of profitable groups have a building maintenance reserve. Only 40% of groups that are running a loss have a maintenance reserve.

Ownership

While there was an even distribution of centers in each category that were owned and leased, deeper statistical analysis indicated a significant difference. Owning a facility is correlated with a 23.6 percentage point reduction in the likelihood of having a surplus. Although we did not specifically touch on this in the survey, there are many reasons why owning a space might not provide the financial stability that an organization expects. The building may be in a need of an extensive amount of renovation and have inefficient building systems. The square footage of the space owned may be greater than necessary. Additionally, if nonprofits are unable to secure property tax exemption for their buildings, this can be a significant expense.
Optimizing your Business Model

The findings in this report can be used by centers at all stages of development to strengthen their social enterprise business model. Centers in the planning stages can use these findings as benchmarks in designing their space, adjusting as local demand dictates. Centers under operation can use these facts to refine their business model and improve their ratio of revenues to expenses. For a quick analysis, practitioners should consider the following:

• What is your ratio of common space to rentable space? If you have flexibility with your space layout, consider transforming some common area into rentable cubicles or offices.
• Reduce your vacancy rate. If you do not have a deed restriction, search for small businesses or missioned-aligned for-profits.
• Expand the number of tenants your space can serve. If you have the available space, consider adding a hot desking or part-time membership model to your community.
• Analyze your expenses on a per square foot basis. Although every space will be different, aim for a cost per rentable square foot as close to $22 as possible. Make sure that you are using part-time or contract staff efficiently.

Conclusion

This report marks the first time that the profitability of the nonprofit shared space model has been reported and analyzed, and the findings validate many common practices across for-profit and nonprofit shared spaces. While there is room for much additional research in this arena, this work shows the importance of the size of a center, proportion of rentable square feet to common area, vacancy rates, and number of tenants. At the same time, this research confirms that successful nonprofit centers are largely not dependent on fundraising. Additionally, it dispels the myth that taking on debt financing ensures that a nonprofit center will continually run at a loss. This report does not contain the ultimate recipe for profitability; shared spaces find many ways to make their business models work. It does, however, demonstrate clear indicators for financial strength in this model.