

OVERHEAD MADNESS

A LOOK AT GRANTMAKING POLICIES AND PRACTICES IN FUNDING
REAL COSTS IN CALIFORNIA

REAL COST PROJECT: RESEARCH SUMMARY

A summary of the research and findings from the Real Cost Project, a joint statewide initiative of Northern California Grantmakers, San Diego Grantmakers, and Southern California Grantmakers.

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REAL COST PROJECT: RESEARCH SUMMARY

The Real Cost Project is a joint statewide initiative of Northern California Grantmakers, Southern California Grantmakers and San Diego Grantmakers. The goal of the Real Cost Project is to increase the number of funders that provide real-cost funding and to build the skills and capacity of all those engaged in grantmaking, including foundations, corporations, individuals, and government.

The critical first step of the project was to collect information and baseline data on the spectrum of current funder and sector practices that relate to real cost funding. This research allowed for a more thorough conceptualization of real cost funding as well as an opportunity to understand existing challenges, gaps, and needs. Most importantly, the research set a foundation for how future discussion and trainings should be developed to meet the real needs of practitioners in the field.

From February to May 2015, research was conducted through qualitative methods, including an environmental scan of research and studies related to funding of overhead and one-on-one interviews with practitioners in the field statewide. Interviews were conducted with Board Members, Executive Directors, and Program Officers, representing a variety of funder types, including corporate foundations, family foundations, community foundations, giving networks, public endowments and individual donors. Overall, the research focused on the following primary areas of interest:

- Grantmaker definitions of overhead and real cost funding
- Defined policies and practices around overhead and real cost funding
- Methods and tactics of engagement between nonprofits and funders
- Nonprofit infrastructure evaluation
- Biases that knowingly or unknowingly influence funding decisions
- Organizational barriers and challenges which limit or prevent real cost funding adoption
- Best practices to be modeled and adopted

PROJECT PARTNERS

Northern California Grantmakers

San Diego Grantmakers

Southern California Grantmakers

FUNDERS

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California Community Foundation

The William and Flora Hewlett Foundation

The David and Lucile Packard Foundation

The Parker Foundation

The Ralph M. Parsons Foundation

Weingart Foundation.

REAL COST FUNDING IN PRACTICE

The research yielded several major findings, revealed common practices in the field and pinpointed areas for skill building and training among the grantmaking community. Key takeaways include:

There is a lack of well-defined policies to guide real cost evaluation and reimbursements

According to a study by Grantmakers for Effective Organizations, 59% of foundations did not have formal policies around overhead rates (Peeler, 2015). Likewise, interviews showed a similar pattern with a significant lack of formal policies¹ around overhead and indirect costs. Funders often operated with an unwritten “commonly accepted rate of about 10-15%,” which was highly negotiable depending on several conditions such as a grantee’s current needs, a grantee’s existing or past relationship with a funder and a funder’s giving priorities (Interview Series, 2015). Additionally, funders often unintentionally signaled a limitation or overhead funding cap within their grantmaking process. For example, funders that provided a budget template for grantee applications often automatically calculated a fixed overhead percentage in the budget template. Finally, while some formal policies existed around funding university grants, they did not commonly exist in 501(c)3 settings.

There are no standard definitions of terms related to overhead and real cost funding

Terms such as overhead, indirect, administrative and operational costs are loosely defined or used interchangeably with inferential meaning. As a result, there is a lack of shared or common language across the field. In the 2010 Report to the Chairman, Committee on the Budget, House of Representatives produced by the US Government Accountability Office, a similar situation is described in governmental reimbursement processes, where “inconsistencies in the use and meaning of the terms indirect and administrative, and their relationship to each other, has made it difficult for state and local governments and nonprofits to classify costs consistently” (US Government Accountability Office, 2010). Also, there was little if any training provided to program or grants management staff on how to calculate or determine actual overhead or indirect costs.

Funders rely on individual staff members to make decisions around real cost funding

Due to the absence of formal policies for funding overhead combined with the lack of a standard definition of overhead, decision-making is delegated to program, grants management and/or financial staff who have little or no formal training on determining full cost. These staff members are often tasked with making crucial recommendations on what is considered overhead and program allocations with no formal guidance.

Funder practices driven and reinforced by cultural norms and perceived “best practices” in the field.

An adherence to these accepted cultural norms in the sector at large, as well as within institutional cultures at individual grantmaking entities, resulted in radical differences in practices. Approaches were often adopted based on past practice and reinforced by unchanging processes and a reliance on individual approaches by program officers. In interviews, these methods were often referred to as “rules of thumb,” “what’s reasonable or acceptable,” and “the way we’ve always done it” (Interview Series, 2015).

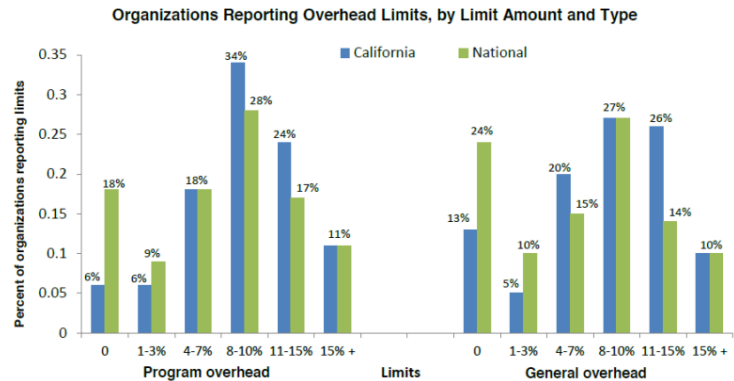
¹ Policies refer to formally recognized amounts in percentage, dollars, etc. that grantmakers fund

THE IMPACT ON NONPROFIT ORGANIZATIONS

The lack of formal policies and reliance on perceived “best practices” results in drastically inconsistent approaches to funding. In focus groups conducted by California Association of Nonprofits (CalNonprofits), nonprofits reported that their funders cover anywhere from 0% to 17% of indirect or overhead costs. And the nonprofits also reported inconsistencies in definitions of overhead, lack of standardization in grant applications, and the need to educate grantmakers around overhead issues.

Nationally and within California, research shows that funding for nonprofits organizations generally fails to cover the full cost of programs and services. Roughly seven in 10 nonprofits in California say the government funding they receive fails to cover the full cost of their services, according to *Nonprofit-Government Contracts and Grants: California Findings* a new report from the Urban Institute. A majority (64%) of California nonprofits reported that government contracts and grants pay only 10% or less for overhead costs. (Urban Institute, 2015).

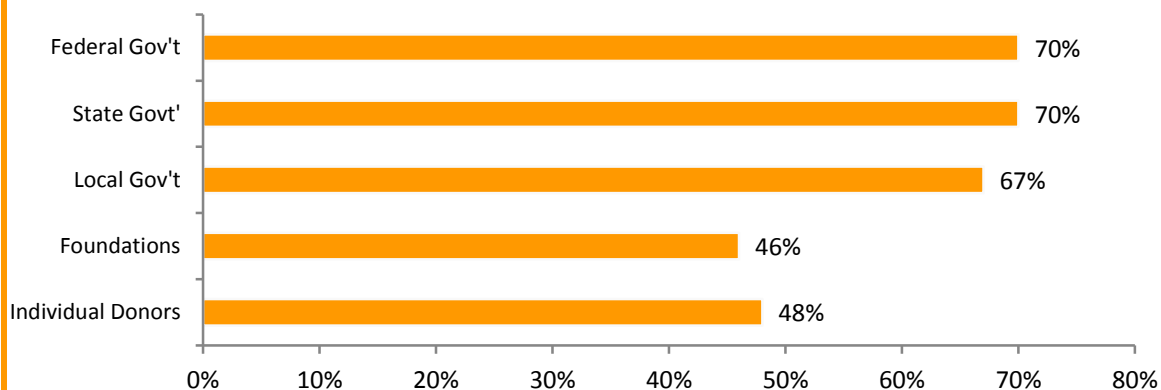
Nonprofits Reporting Limitations on Full Cost Recovery from Government Contracts and Grants



Additionally, Nonprofit Finance Fund recently released the findings of the *2015 State of the Nonprofit Sector* that included results from a survey of more than 1,100 nonprofit organizations across the state of California. The research revealed that the top challenges nonprofits are facing are achieving long-term financial sustainability, attracting and retaining staff and raising funding that covers the full cost (Nonprofit Finance Fund, 2015 State of the Nonprofit Sector Survey). When organizations were asked if funding covered the full cost of achieving outcomes, the overwhelming answer was “No.”

HOW OFTEN DO FUNDERS COVER THE FULL COST OF THE PROJECTS THEY FUND?

Percent of nonprofits that said funders Rarely or Never cover the full cost



Source: Nonprofit Finance Fund 2015 State of the Sector Survey.

These limitations on full cost recovery lead to several problematic consequences in the nonprofit sector. In an article titled *Paying for Not Paying for Overhead*, authors Hager, Rooney, Pollack and Wing claim that overhead limitations impact critical capacity and infrastructure needs of nonprofits, including staffing and technology. They say, “Limits on administrative costs are a cause for concern because nonprofits must find ways to cover those costs. Trying to minimize overhead costs might lead nonprofits to offer low pay for administrative positions, making it difficult to recruit and retain skilled and experienced staff. Or they may forgo investments in technology, reducing productivity and effectiveness” (Hager et al., 2005).

Most nonprofits in the state are operating with little or no safety net, with 53% of nonprofits report having three months or less of cash of hand (Nonprofit Finance Fund, 2015). And for nonprofit organizations serving low-income communities, 60% of organizations reported having less than three months of cash readily available (Nonprofit Finance Fund, 2015). Lack of liquidity means scrambling to manage payroll, cutting or reducing programs, and reducing staff hours or eliminating staff positions. These organizations do not have the financial capital to withstand risk and adapt to changes in the communities they serve.

MONTHS OF CASH	CALIFORNIA NONPROFITS OVERALL	CALIFORNIA NONPROFITS SERVING LOW-INCOME COMMUNITIES
<1 Month	13%	14%
1 -3 Months	40%	46%
TOTAL (LESS THAN 3 MONTHS)	53%	60%
3 Months +	47%	40%

Source: Survey data from Nonprofit Finance Fund's 2015 State of the Nonprofit Sector Survey

While nearly 80% of nonprofit organizations have reported an increase in demand, only 44% said they could meet that demand. Among organizations serving low-income communities, only 35% of nonprofits could meet the demand for often critical safety net services. The result is that everyday people in our communities are being denied access to critical services from healthcare to workforce development to childcare.

ABILITY TO MEET DEMAND	CALIFORNIA NONPROFITS OVERALL	CALIFORNIA NONPROFITS SERVING LOW-INCOME COMMUNITIES
YES	44%	35%
NO	56%	65%

Source: Survey data from Nonprofit Finance Fund's 2015 State of the Nonprofit Sector Survey

CONCLUSIONS

Current funder practices regarding the funding of overhead and indirect costs varies radically across the sector, resulting in confusion for both funders and nonprofit organizations, systematic underfunding of nonprofit organizations and programs, and contributes ultimately to a nonprofit organization's inability to meet demand for services and programs. Ironically, practices that were initially intended to help promote efficiency and effectiveness of nonprofit organizations are in fact undermining nonprofit's abilities to achieve their mission and resulting in less impact and fewer or worse outcomes.

Lack of formal policies regarding funding of indirect costs, lack of definition of key terms such as overhead, lack of formal training on determining actual program or organizational costs, and discretion left to program or grants management staff with limited training in nonprofit finance, all contribute to a vicious cycle of underfunding, limited liquidity, weak infrastructure and inability to meet demand.

Fundamentally, a sector wide acceptance of past practice and adherence to cultural norms undergirds the issue of real cost funding. This finding points to the need for human-centered approaches and a shift in behavior, rather than institution of policies alone. The Real Cost Project is exploring how to change these perceptions and long-held (but unsubstantiated) beliefs about indirect costs and effectiveness. This work will be rolled out in the second phase of the Real Cost Project in Fall 2015.

ABOUT THE REAL COST PROJECT

All of us involved in philanthropy today – foundations, individual donors, corporations, government, nonprofits, and community leaders – recognize that the social sector is in the midst of a radical transformation.

Accordingly, grantmakers across California are examining their practices and looking to develop new approaches in order to increase impact in the communities they serve. Recently, many grantmakers have begun exploring an approach based on real cost funding – that is all of the necessary investments for a nonprofit organization to deliver on mission and to be sustainable over the long term.

The Real Cost Project

In response to these efforts, Northern California Grantmakers, San Diego Grantmakers and Southern California Grantmakers are proud to announce the launch of a joint statewide initiative – the Real Cost Project – to increase the impact of philanthropy across California. Created by funders for funders, the Real Cost Project will explore what it takes for funders to develop new grantmaking practices based on what it really costs to deliver outcomes.

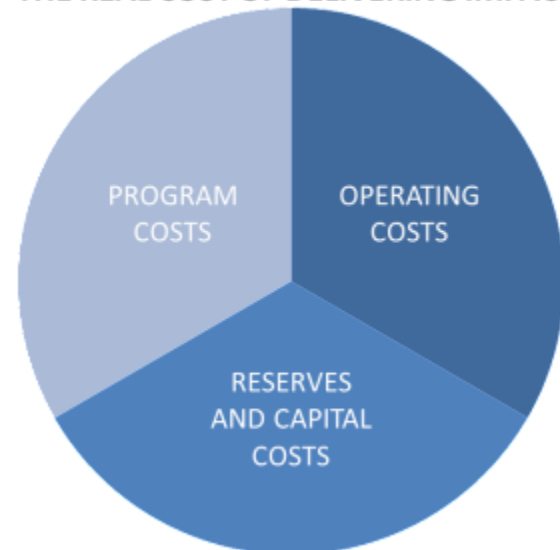
We invite you to get engaged in this growing national conversation. Whether you provide general operating support, programmatic support, funding for capital projects or investments for social impact, understanding what is the real cost for delivering outcomes is critical to achieving your goals.

Real Cost Funding

Real Cost funding is a holistic approach to grantmaking that starts with the end in mind – what are the outcomes we are looking to achieve and what does it *really* cost to deliver those outcomes? By understanding what is the real cost for delivering those outcomes, funders can then determine what role they want their grant dollars to play in supporting their grantees.

Simply put, the real cost of outcomes includes all of the necessary costs for a nonprofit organization to deliver on mission and to be sustainable over the long term. Like any enterprise – including for-profit corporations – nonprofits must be able to cover the real cost of their programs and operations if they are to deliver excellent outcomes. Whether an organization is serving the needs of returning veterans, providing health and human services to the most needy, or building vibrant communities, the cost of delivering results includes not only direct programmatic expenses but also the capacity and capital needs of the organization.

THE REAL COST OF DELIVERING IMPACT



FUNDERS

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ADVISORY COUNCIL

The Real Cost Project Advisory Council works in partnership with the California regional associations of grantmakers to identify and develop best practices, policies, and guidance on what it takes for funders to effectively change their grantmaking.

- Aden Bliss, CFO, The Ford Family Foundation
- Vera de Vera, Director, Community Building Initiative, California Community Foundation
- Sylvia Obagi, Executive Director, Roy and Patricia Disney Family Foundation
- Lindsay Louie, Program Officer, Effective Philanthropy Group, The William and Flora Hewlett Foundation
- Linda Baker, Program Officer, Organizational Effectiveness, David and Lucile Packard Foundation
- Judy McDonald, President, The Parker Foundation
- Jennifer Price-Letscher, Senior Program Officer, The Ralph M. Parsons Foundation
- Elizabeth Dodson, Director of Grantmaking and Grantee Impact, Silicon Valley Venture Fund
- Vy Nguyen, Program Director, Weingart Foundation