Barnes Foundation – Case Analysis

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EXECUTIVE SUMMARY

Many substantial questions remain unanswered in the Barnes Foundation feasibility assessments conducted by Deloitte Development LLC and Perks Reutter Associates. Therefore, proceeding with the Foundation's plans to move the collection to Philadelphia at this time would be hasty and precipitous.

The "Barnes Foundation, Financial Analysis: 3-Campus Model" (Deloitte Development LLC (D&T), September 2004) report represents a cursory approach to examining the financial drivers that affect museum operations and does not purport to present a prediction of the future. The "Capital Cost Analysis for a New Facility for the Barnes Foundation" (Perks Reutter Associates (PRA), July 2004) report provides almost no solid evidence to the assertion that the capital costs for a new facility will be within a feasible $100 million range. Additionally, there are inconsistencies between the "Overview of Financial Position" (D&T September 2002) report and the D&T September 2004 report, which make the calculations on the 2004 report suspect.

The Foundation has proposed a drastic plan because it has concluded that operating in its present facility is not feasible, and that, over the short term, it will run out of operating funds and be forced to cease operations. My conclusions are the following:

- The D&T report of September 2002 does not definitively prove that the Foundation will run out of operating costs;
- The level of risk of maintaining the status quo is not demonstrably higher than moving; and
- That a number of alternative scenarios for future operation have not been pursued.

I believe that there is a medium to high level of risk that the Foundation's proposal will require substantially more than the $100 million estimated, both earned and unearned, to break even on an ongoing basis. Furthermore, in my experience, new building projects of complex cultural institutions have high levels of unpredictability. Therefore, I recommend that, before rendering a decision on the level of risk the Court is ready to assume, at least three additional studies be conducted:

- A capital fundraising feasibility study;
- A more detailed building program plan that will, in turn, provide the information required of a professional "cost estimator" to ensure that the building costs are closer to actual; and
- A statistically valid market survey, including a detailed pricing survey, to evaluate the attendance and income projections.

Additionally, I recommend that each individual prospective board member be reviewed to evaluate their ability as fundraisers and to determine agreed upon personal responsibilities for raising funds. I also recommend that, before proceeding, legally binding pledges be obtained for at least 50% of the capital required for building construction and the endowment.

Ultimately, the Court must determine whether the Foundation's proposal is *"the least drastic modification"* and that the *"bold proposals …will accomplish the desired ends."* This author concludes that, based on the evidence provided, neither of these conditions are adequately satisfied.

ANALYSIS

The following report evaluates three documents:

- Section I: “Barnes Foundation, Financial Analysis: 3-Campus Model,” Deloitte Development LLC (D&T), September 2004
- Section II: “Capital Cost Analysis for a New Facility for the Barnes Foundation,” Perks Reutter Associates (PRA), July 2004
- Section III: “Overview of Financial Position,” D&T, September 2002

This evaluation does not address the legal issues or the artistic merits of the Barnes Foundation’s proposed program but rather addresses questions regarding the associated risks and ongoing viability of the proposed move of the collection to a location in downtown Philadelphia.

The first point to address is that these reports cannot be taken as an informed prediction of the future (as admitted to in D&T, Sept 2004, p.3) because ….

> *“The purpose of this effort is to analyze the reasonableness of estimated operating revenues and expenses. It is not a prediction of future results.”*

The reasonableness of any plan, since it is not a prediction of future results, must be judged by an informed decision maker. In cultural institutions, plans such as D&T 2004, are frequently commissioned by the board leadership to determine the conditions upon which the plan can be executed and the level of risk the board is willing to accept. The D&T 2004 plan identifies some of the conditions that shall be discussed below but does not ascribe a level of risk that each of the assumptions carries. For example, the report presumes post-opening attendance but does not define a level of probability of attaining that number nor a range of outcomes (conservative, realistic, or optimistic). As is explored below, much of the earned income (admissions, shop sales, restaurant income) is predicated on, and tied to, specific attendance figures; small deviations in attendance could cause large deviations in earned income.

Second, much of the data presented in the D&T 2004 report is corroborated by benchmarking. In the author’s opinion, benchmarking is unreliable because a) the sample used is often too small to have any statistical validity, and b) there are dozens of conditions that exist in each benchmarked institution (in this case, cultural organizations) that have a material bearing on the results: e.g., ability and stability of the management; culture of the organization; willingness, influence and resources of the board to raise endowment and annual operating income; availability, periodicity and quality of changing exhibitions, etc. There is similarly problematic reliance on benchmarking in the PRA report.

Section 1: "Barnes Foundation, Financial Analysis: 3-Campus Model," D&T, Sept. 2004

The following section will review some of the executive summary of the D&T 2004 report (pp. 2-19).

Omissions in the Analysis
First, the report concedes to excluding two specific items in the assessment—changing exhibitions and capital replacement costs—which I contend, is a serious flaw in the analysis.

> *"…this analysis does not include two specific items: revenues and expenses of a changing exhibition program and a capital replacement budget…" (p.4)*

<u>Changing Exhibitions:</u> Any hope of maintaining the level of attendance projected in the D&T report will depend on changing exhibitions—more specifically, important, blockbuster-type exhibitions. Even the Philadelphia Museum of Art, which owns arguably one of the best and most diverse collections in the country, must present changing/traveling blockbuster exhibitions to drive repeat attendance of local citizens, to compete for tourist visitors, to provide a "hook" for new advertising, marketing and promotions, and to generate new products for shop sales.

Traveling exhibitions share many characteristics of Broadway shows: the growing demand toward bigger and flashier leads audiences to expect blockbusters ("Phantom of the Opera"/"Van Gogh") and become less satisfied with anything less[1]; the costs of blockbusters have risen and the risk of breaking even or making a profit has become higher; the availability of proven product has diminished; the required size and flexibility of space of the venues has eliminated some venues (theaters/museums) from competing for the traveling shows; and the cost of exhibitions has risen due to increasing competition among venues for the blockbusters. In addition, the cost of insuring works of art for travel and the reluctance of collectors and museums to lend works for special exhibitions—for geopolitical and other reasons—have increased the costs and decreased the number of traveling exhibitions.[2]

The Barnes will need to present changing and traveling exhibitions, but there is a high degree of risk that these will not be break-even ventures. In addition to the income required as presented in the D&T report, I recommend adding an additional $100,000 to $150,000 annually to fund the net deficit arising from changing exhibitions.

<u>Capital Replacement Costs:</u> In the late 1980's through the 1990's many of the great museums suffered from crumbling exteriors, leaking roofs and inadequate attention to collection care. Even the Philadelphia Museum of Art suffered from cracked front steps and inadequate rest room facilities because resources were scarce, and those resources

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[1] See Philippe DeMontebello's opinion piece in the *New York Times* lamenting this phenomenon
[2] The covenants preventing the foundation from lending works in the collection would further retard the Foundation's ability to borrow works from other museums.

available were directed toward salaries and programs and away from capital replacement. Best practices today require museums to create a reserve for capital replacement. Although there is no exact dollar amount required for capital replacement, one measure is the depreciation on property. On the balance sheet, while the physical assets are depreciated by some accounting formula, the total assets are preserved by reserving capital in a designated fund. Considering the Foundation's desire to preserve the collection and present it to the widest audiences in perpetuity, capital replacement costs should be accrued and added to annual operating expenses. Assuming 2% of the building cost, this would add $2 million to the annual operating costs. In light of the Overview analysis (D&T, 9/02), current best practices in the field, and consistency of analysis, this would require adding depreciation to the operating *pro forma*.

Programming and Access
The ability of the Foundation to fulfill and enhance its mission is outside the purview of this report.

Financial Structure
There are some questions regarding the financial assumptions of the D&T report. First, the D&T report assumes that the Foundation will need and can actualize a $50 million endowment. The financial projections assume that the entire $50 million in endowment is in-hand, invested and capable of producing a 5% return by "move year." The report asserts that 5% is a "…draw rate … which is comparable to benchmarks." However, endowment best practice calls for a draw rate based on a three-year rolling average. A $2.5 million endowment draw would not be possible, under those conditions, until three years after the entire $50million was invested; therefore, the $50 million would be required by year "-2." Furthermore, the report unrealistically assumes that all of the pledges will be received immediately upon pledge. Most pledges are multi-year promises (e.g., "$3 million over three years") or a combination of immediate contributions and planned giving (e.g., "$1 million now and $2 million upon the death of the donor"). A prudent approach to lessen the risk that the endowment would not be raised would be to conduct a feasibility study that demonstrates the capacity to raise the $50 million. This type of study, while not a guarantee for success of a campaign, lessens the risk of failure. Additionally, the Foundation should require legally-binding pledges for lead gifts (at least 50% of the total).

- *I urge the Court to obtain advice from a disinterested, experienced, capital campaign consultant, before assuming the endowment goal of $50 million can be achieved and that the Foundation may begin to draw down $2.5 million annually in the near term.*

Second, the report assumes that the Foundation will earn 41% of the income required to break even. This amount is 35% to 80% higher than the benchmark data presented within the same report (p.42).[3] This also assumes that attendance (and related income, sometimes referred to as "per caps") meets these projections. If attendance were lower

[3] While I contend that benchmarking data is not a useful tool for prognostication, the overly optimistic income ratio represents a cause for concern.

(for any reason such as lack of interest [doubtful]; or bad weather, security alerts, or unavailability of changing exhibitions [more likely]), then earned income would drop, requiring additional annual fundraising to break even.

Third, annual development income, particularly for unrestricted general operating support, is most difficult to raise. Raising unrestricted grants requires research, cultivation, solicitation and stewardship, as well as an emotional, rather than *quid pro quo* connection, to the organization. Those most likely to contribute are they who have given in the past; therefore, successful fundraising requires time as well as effort and expertise. Finally, successful fundraising requires a fundraising board whose members will not only have the capacity to donate but who will agree to donate and to solicit from others.

> ➢ *I recommend that an evaluation of the board members and their capacity to contribute, as well as evidence of board orientation material that describes the prospective Foundation board members' fundraising commitments, should be required.*

Construction and Capital Costs
I will comment on construction and capital costs within the Perks Reutter analysis in Section II.

Detailed Assumptions (p. 20-28)
Attendance, both opening year and on-going, is the critical factor to success based on this model. Attendance will drive admission income, gift shop sales, memberships, and restaurant profits directly. Attendance is required to receive government grants and sponsorships, and there is a close correlation between the satisfied visitor and the contributor. The D&T report states clearly that *"…a primary statistically valid market survey would be required to determine the true demand for the collection."* (p.23). Although there may be an arithmetic correlation between attendance and such factors as MSA, visitors per square foot (though the D&T report is not specific in qualifying if this is total square feet, exhibition or education space; public versus collection storage), and attendance of like institutions, some of the more reasonable and accurate indicators of on-going annual attendance are the following:

- Quality and diversity of the programs;
- Ability of management to make smart decisions regarding advertising investment and placement;
- Customer service;
- Changing exhibitions;
- Creation of a strong, identifiable brand; and
- Competition and/or collaboration with other institutions.

> ➢ *I recommend, and the D&T 2004 report implies, that a statistically valid market survey be conducted to accurately determine attendance figures. I also recommend that the court review management's plans to address the attendance drivers listed above before determining the potential of achieving the attendance projections.*

Section II: "Capital Cost Analysis for a New Facility for the Barnes Foundation," PRA, July 2004

I have serious concerns regarding the methodology, and therefore, the accuracy, of the Perks Reutter Associates (PRA) capital cost analysis. PRA bases its cost for construction analysis on benchmarking (p.9). The survey of eight museums, of various sizes and types, does not constitute a statistically valid sample. Even using regression analysis, the level of accuracy is very low. Additionally, three of the museums have not been completed and at least two of the museums cited (i.e., Milwaukee and Atlanta) are additions, not new construction.

Even using the data presented in the PRA report, however, I interpret the conclusions quite differently. The range of adjusted cost per square foot (psf) of the benchmarked institutions is $375 to $759. The range of square feet planned for the Foundation's new facility is 120,000 to 150,000. Using the low and the high, I project a range of $45,000,000 to $113,500,000 for construction alone. Adding to that the PRA estimates for ancillary costs, the total cost of the project could be from $75 million to $143.5 million. Yet, I believe that this is an academic exercise and would recommend that there are many unknowns that could radically increase the cost of construction. Of the proposed 120,000 to150,000 square foot museum, one would need to know how the space is allocated: the proportion designated for exhibition space, administrative office space, collection storage, public spaces (atria, restaurants, gift shops), education spaces, etc. Additionally, construction materials must be contemplated (e.g., limestone, marble, poured concrete, titanium clad, etc.). A cost consultant cannot provide an estimate for the cost of building a cultural facility based on psf averages alone, but rather must consider the complete building program.

There are numerous cases of well-known, mature museums that have completely miscalculated the cost of new construction. For example, according to the *Milwaukee Journal Sentinel* (5/18/02 and 7/26/03), the Milwaukee Museum of Art's new wing construction was originally projected to cost $38 million in 1997. When it was completed, the construction costs had ballooned to $120 million (or $845 psf unadjusted or indexed) from a revised projection of $100 million.

- *I recommend that before any decisions are made to move ahead on building a new facility for $100 million, a more detailed program plan should be presented and a professional cost estimator, with prior experience estimating costs for museums, is consulted.*

Section III: "Overview of Financial Position," D&T, Sept. 2002

Sections I and II outline the high levels of financial risk associated with the Foundation's proposal before the Court. The level of risk, however, must be compared to the alternative. Is the Foundation's proposal more drastic than the "as-is" scenario, a scenario presented in the D&T "Overview of Financial Position" that demonstrates the depletion of liquid assets through sustained losses?

There are numerous inconsistencies in reasoning between the D&T 2002 and 2004 documents. These inconsistencies add a significant level of doubt regarding the conclusions of each. For example, on the income side, the 2002 overview assumes a $5.00 admission fee while the 2004 report assumes an average $9.00 admission fee (equivalent to an estimated top admission fee of over $15.00). Additionally, the 2002 report assumes sharply reduced unearned income while the 2004 report shows significant fundraising income. On the cost side, the 2002 Overview includes depreciation of $425K per year (p.29), yet the 2004 *pro forma* for the new facility include no charge for depreciation.

Additionally, the 2002 report assumes that the Collections Assessment program will incur a net loss of approximately $2.1 million over three years, but provides no explanation or reason for this loss. The 2002 Overview also assumes very high professional fees (one assumes, due in part, to the cost of the legal proceedings) that would not continue in an as-is scenario. I also question the cost for salaries/taxes/security. In general, the expense of personnel as a percentage of income in almost all mid-sized museums (using a large sample group) is between 50% and 70%. The Overview projects that personnel cost in 2004 would be 120% of income. I contend that the personnel costs of the as-is operation could be reduced to be in line with industry standards.

Increasing the price of admissions, adding admission days, and continuing the development effort—combined with reducing costs and eliminating depreciation from the *pro forma*—would paint a very different, and less dire, as-is scenario.

CONCLUSION

I believe the Foundation's proposal represents a high risk. Too many assumptions, as yet unproven, add to the level of risk of failure. The Barnes collection could move to Philadelphia and perhaps the funding to construct a new building could be raised. There is no hard evidence, however, that the endowment funding is guaranteed, and there is a high risk, with too many unknown variables, to demonstrate that the new facility would operate in the long-term on a break-even basis. This drastic solution is high risk and yet the alternatives for improvement at the present facility have not been adequately vetted.

It is true that the Barnes Foundation has sustained losses. Modern museum management, however, is replete with case studies of financial turn-arounds. One need only examine the recent history of the Brooklyn Museum of Art for a case study in how innovative management, combined with conviction of the board and stakeholders, turned a moribund museum into a financial and artistic success. The best museum managers are innovative, creative, and seek new solutions—even within significant constraints—to affect positive change. The as-is scenario assumes no innovation, no creativity, no striving for the new.

It is also true that the Barnes' restrictions present many constraints. A case worth studying for creative solutions to restrictions of the donor is that of the Terra Foundation for the Arts, where the Illinois Court imposed restrictions on the location and exposition of the collection of the late industrialist Daniel J. Terra. I would also encourage a review of the de-accessioning program that another educational institution with a large art collection, the Peabody Conservatory in Baltimore, undertook.

The constraints upon the Barnes can be overcome by less drastic and highly risky options than those proposed. These options depend upon the innovation, best intentions and dedication of all of the stakeholders—present and future—of the Foundation.

About the author of this report

James Abruzzo, the author of this report, is Managing Director of DHR International's Nonprofit Practice, a management consulting group that specializes in cultural and other nonprofit institutions. Over his 25 years as a management consultant, numerous art museums, botanical gardens, historic houses and other cultural institutions have retained him. Recently, he was retained by The Terra Foundation for the Arts, which sought answers to questions regarding new directions for the foundation, its collections, and museum building and properties in Giverny, France. Mr. Abruzzo is the author of Jobs in Arts and Media Management, a textbook on the arts management field, and numerous articles on cultural management. He is a Professor and co-Director of the Center for Leadership in Nonprofit and Philanthropic Management at Rutgers University Business School. He is chairman of Dieu Donne` Paper Mill, a nonprofit visual arts organization in NYC; a board member of the Alvin Ailey American Dance Theater; and was President of the Staten Island Institute of Arts and Sciences, an art, history and natural history collection museum that also manages green spaces in Staten Island.

Mr. Abruzzo has spoken at the Association of American Museums, was the keynote speaker at the Art Museum Administrators conference and is the creator of the cultural confidence index, an ongoing measurement of the level of optimism of cultural leaders in New York City, Chicago and Berlin. He is often quoted in the Arts Newspaper, the Chronicle of Philanthropy and NPR reports on the arts industry. The author has visited the Merion Gallery.