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Hospital Conversion Foundations: Keeping the Community Promise After a Transaction Closes

When a not-for-profit health system decides to pursue a sale to a larger organization, board members are often concerned that they will be giving up the ability to influence community health at the local level. This need not be the case, however: structuring the deal to create a resulting community foundation can ensure that community health will be supported into the future. Resulting community foundations are governed by an independent and local board of directors, separate from the health system, and are endowed with funds that can address local health needs and other issues that the health system may not have otherwise had the means to take on – unlocking new, incremental value for the community.

Creating a community foundation

Resulting community foundations are most commonly created in one of two transaction scenarios:

- A for-profit organization acquires the smaller not-for-profit health system and the net purchase price is used to fund the foundation.
- A larger not-for-profit health system acquires a smaller system that is a position of financial strength, with significant excess cash that does not need to come along with the transaction.

Regardless of the source of funding, the funds are put to a common use: they create an independent, not-for-profit foundation with its own identity and governance structure able to define its own mission, vision, and grant-making priorities.

If funds for a foundation are available, there are several decision points that will affect the foundation's structure, duration, and activities and operations.

Life of the foundation.

This is a decision that may be influenced by the amount of money available to fund the foundation. A smaller foundation may want to use its funds to make a big impact in a few areas of focus and spend down the foundation's funding within a matter of years. A foundation with more significant funds may be able to continue "into perpetuity," meeting the requirements for annual spending on grants and qualified operating expenses required by the Internal Revenue Service while continuing to maintain or grow its asset base.



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Key Questions

When determining the identity, scope, and governance structure of the foundation, key focus areas and questions include:

- **Activities:** To best fulfill our community promise, should our ongoing activities include grant-making, operating, and/or fundraising?
- **Geography:** Which communities should our foundation support?
- **Impact:** Should our foundation exist to create maximum impact in a time-limited period or sustainable ongoing impacts in perpetuity?
- **Board Composition:** What skills and experience are needed to fulfill our mission and purpose?

Scope of foundation activities. There are several options to consider. The foundation might be focused solely on grant-making. It might have both grant-making and operating programs (e.g., funding and operating its own community food bank). Or it may want to include fundraising activities to support and grow the foundation's assets. These choices will have implications for both legal structure and operational requirements.

Identity of the foundation. This includes the foundation's mission, vision, and grant-making priorities. Community foundations can be narrowly focused on a few priorities or have wide-ranging interests that address multiple social determinants of health in the community (e.g., housing, transportation, economic stability, food access and security, and education). Community needs assessments conducted by the health system or a community health organization are often used to identify grant-making priorities when the foundation is created.

Generally speaking, the broader the scope of the foundation's activities, the more resources and staff will be required to support its mission. Foundations may have a staff of just a few people or a staff of 50 or more individuals.

Foundation governance. The size and complexity of the foundation and its operations will affect the composition of the board and its committees. There is often some continuity between pre-transaction membership of the board of the health system that is being acquired and membership of the newly created foundation, enabling health system board members to continue their community service with the resulting foundation. Given the community foundation's focus on local needs, the governance model is typically structured to include voices of community leaders involved in or affected by the foundation's mission and activities. Options include designating seats on the board for these community

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leaders or creating a community advisory council to provide information and insights to board members.

Typical committees include a finance or investment committee, a committee that oversees the foundation's grant-making activities, a nominating committee, and a committee that oversees compliance with and amendments to the foundation's bylaws and covenants. Boards of larger foundations may also have committees focused on human resources, for example, or foundation communications.

Community foundation boards can have some unique oversight functions related to the transaction that created the resulting foundation. The acquiring health system may make commitments to the local hospital to fund certain capital projects, for example, or maintain certain service lines for a period of years following the transaction. In this case, the community foundation board will often have the authority to monitor and enforce compliance with these commitments.

These decisions will form the framework for the community foundation and its identity, structure, and governance model. As part of the pre-closing process, workstreams can be established to have the foundation ready to begin operating once the transaction closes so that the foundation may begin making positive impacts in the community as quickly as possible. A summary of the typical workstreams and objectives for creation of a community foundation are shown in Figure 1.

Figure 1: *Creating a Community Foundation – Workstreams and Objectives*

| Workstream | Objectives |
|---|--|
| Establish the foundation’s identity | <ul style="list-style-type: none"> • Draft, refine, and establish the mission, vision, and grant-making priorities of the foundation |
| Design the governance model | <ul style="list-style-type: none"> • Determine the desired role, committee structure, composition, and meeting cadence of the foundation board • Establish post-closing enforcement oversight, if applicable |
| Hire administrative leadership and staff | <ul style="list-style-type: none"> • Hire, orient, and onboard lead executive and support staff complement to operate the foundation • Develop initial HR infrastructure (e.g., employee handbook, conflict of interest statement) |
| Select ongoing third-party vendors | <ul style="list-style-type: none"> • Conduct RFP process to evaluate and select third-party vendor services for key “day 1” functions (e.g., investment management, tax, accounting, audit, banking, legal, insurance) |
| Complete operational requirements | <ul style="list-style-type: none"> • Establish operational infrastructure required for “day 1” and “year 1” operations (e.g., payroll, branding, website, office space) |
| Legal | <ul style="list-style-type: none"> • Determine legal and tax structure • Develop articles and bylaws • Complete legal structure transition for pre-close vs. post-close operations |
| Wind down (if applicable) | <ul style="list-style-type: none"> • Evaluate and select consultant to successfully manage the wind down of relevant legacy assets and liabilities, if any |

The decision to partner with another organization through an acquisition process is always a high-stakes decision for a board. But for organizations that decide to make this move from a position of strength, the creation of a community foundation is one way to ensure that the health system’s focus on its community not only remains intact, but also unlocks new potential to improve the lives of community residents. A transaction that creates a community foundation can both mitigate the

financial risk that smaller health systems increasingly face in today’s difficult operating environment and create an entity able to address community health issues with resources the health system may not have had access to. And for board members, creation of a foundation can offer opportunities to continue their service to the community through dedication to and expansion of the charitable community promise originally fulfilled by the health system.

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