MERGER CASE STUDY

Merger between Mesa Community Action Network (MesaCAN) and A New Leaf, Inc. (A New Leaf)

This case study is based on CAPLAW's interview with Kathy Di Nolfi, Executive Director of MesaCAN, and Michael Hughes, CEO of A New Leaf. This case study presents an example of a parent-subsidiary merger between a small, non-profit CAA facing significant financial challenges and a larger, more financially robust non-profit organization providing overlapping social services in the same service area.

Mesa Community Action Network

At the time of the merger, MesaCAN was a 501(c)(3) non-profit community action agency (CAA) that provided a variety of anti-poverty services in Mesa, AZ, including homelessness prevention and emergency housing assistance, Low-Income Home Energy Assistance Program (LIHEAP), a men's homeless shelter, emergency food assistance and referrals, Individual Development Accounts (IDA), income tax preparation, and financial literacy classes. MesaCAN had an annual operating budget of approximately $2 million and around 25 employees.

A New Leaf

At the time of the merger, A New Leaf was a 501(c)(3) non-profit organization that provided a broad array of social services in Mesa, AZ, including affordable housing units, domestic violence shelters sand services, a family homeless shelter and services and youth and behavioral health services. A New Leaf had an annual operating budget of approximately $20 million and around 250 employees.

BACKGROUND AND REASONS FOR THE MERGER

Prior to the merger, A New Leaf and MesaCAN were both active anti-poverty agencies in Mesa, AZ and were familiar with each other's work in the area. The two agencies often shared the same clients and were part of the same network of community services organizations. In March 2006, Pat Gilbert, MesaCAN's then-Executive Director, approached Michael Hughes, A New Leaf's Chief Executive Officer, to discuss a possible merger of the two agencies. MesaCAN had been operating at a loss for several years and attempted but was ultimately unable to secure additional funding to support its services and programs. MesaCAN's main facilities—its main offices and its men's homeless shelter, East Valley Men's Center (EVMC)—needed significant repairs, and staff members had expressed concerns about client safety and comfort due to the poor conditions of the buildings. Additionally, one of MesaCAN's key staff members had unexpectedly passed away, leaving a leadership gap at the agency. Faced with looming capital improvement needs and the likelihood of significant programmatic and staff cuts, MesaCAN began exploring options to merge with another non-profit organization in the community.

Although Mesa is the third-largest city in Arizona, residents have always taken pride in its unique small-town feel. MesaCAN was well-known in the community for its work, and while Gilbert realized that MesaCAN would be unable to sustain its operations without outside help, he was also concerned about losing MesaCAN's culture, identity and reputation in a merger. Gilbert spoke to a number of different community agencies he thought might be a good merger partner for MesaCAN, but MesaCAN's Board of Directors ultimately decided to approach A New Leaf because of A New Leaf's track record in merging with other organizations that lacked the financial and operational capacity to survive on their own. The MesaCAN Board of Directors also considered the fact that the two agencies shared similar mission statements and values and were both committed to running programs that would help individuals move towards self-sufficiency.

Unlike MesaCAN, A New Leaf had prior experience merging with other non-profit organizations. Its Board of Directors saw the merger with MesaCAN as an opportunity to strengthen A New Leaf's relationship with the city of Mesa and allow A New Leaf to tap into new funding sources that were available to agencies in the Community Action network. Moreover, A New Leaf's Board of Directors felt that working together with MesaCAN would fill in key gaps in its continuum of services to low-income individuals and identify A New Leaf as a go-to social services agency in the community. A New Leaf had a homeless shelter for families and saw potential operating synergies that could result from working with MesaCAN's men's shelter, as well as from other overlapping client services. However, A New Leaf was concerned about the substantial cost involved in renovating MesaCAN's aging facilities and how the initial capital investment would impact A New Leaf's own programs.

CHOOSING THE MERGER STRUCTURE; AMENDMENTS TO MESACAN'S ARTICLES OF INCORPORATION AND BYLAWS

From the outset of the merger discussions in March 2006, MesaCAN and A New Leaf agreed on the importance of maintaining MesaCAN as a separate legal entity in order to preserve its status as a private, non-profit CAA. Both agencies also wanted to ensure that MesaCAN would continue to provide the anti-poverty services that the Mesa community had come to rely upon and identify with the CAA. Thus, MesaCAN and A New Leaf elected to enter into an Affiliation Agreement by which A New Leaf would become the sole member of MesaCAN and assume day-to-day management of MesaCAN's operations, but would also preserve the separate legal and tax-exempt status of each entity. This merger structure resulted in A New Leaf operating as the parent entity of MesaCAN, the subsidiary entity.

Under the terms of the Affiliation Agreement, A New Leaf assumed operational management of MesaCAN on July 1, 2006. MesaCAN's Board of Directors subsequently approved an amendment to the agency's Articles of Incorporation to broaden the scope of its stated purposes to cover A New Leaf's programs and activities, make MesaCAN a member-based non-profit corporation under Arizona law, and designate A New Leaf as the sole member of MesaCAN. MesaCAN's Board of Directors also approved an amendment to the agency's bylaws to restrict MesaCAN from doing any of the following without A New Leaf's prior approval: (i) appointing or removing any director or filling any vacancy on MesaCAN's Board of Directors, except for directors or vacancies in the low-income sector; (ii) amending its articles of incorporation or bylaws; (iii) appointing or removing any officer; (iv) determining the compensation paid to directors; (v) entering into contracts for goods, services, or facilities; (vi) borrowing or lending money; or (vii) liquidating or dissolving, or transferring, disposing, or encumbering MesaCAN's properties or assets outside of the ordinary course of business.

INTEGRATING THE TWO AGENCIES AND OPERATING SYNERGIES

The Boards of Directors of MesaCAN and A New Leaf started preparing for the integration of the two agencies well before the merger became effective. All of the directors then serving on MesaCAN's Board of Directors were offered the option of joining A New Leaf's Board of Directors, and a number decided to serve on both Boards to help with the transition process. All MesaCAN employees also received offers to stay with the combined agencies following the closing of the transaction, and the agency experienced no attrition during first six months following the closing of the merger.

Following the unexpected departure of Gilbert prior to the closing of the merger, A New Leaf appointed Kathy DiNolfi, who had overseen A New Leaf's homeless shelter program for over ten years, as MesaCAN's Executive Director. Given A New Leaf's lack of experience with CAAs, DiNolfi knew that she needed to learn as much as she could about the Community Services Block Grant Act (CSBG Act) and the Community Action network. She spent her first three weeks at MesaCAN simply observing the organization and gathering information about how to run a CAA. DiNolfi knew that MesaCAN staff members' institutional knowledge and familiarity with CSBG requirements would be extremely valuable in the transition period, but she also recognized that relying exclusively on past practices could hinder innovation at a time when the agency had an

unique opportunity to think strategically about its future.

Under the terms of the Affiliation Agreement, A New Leaf assumed responsibility for all of MesaCAN's financial management, grant writing, information technology and human resources functions, streamlining the two agencies' administrative systems. The combined structure allowed both agencies to evaluate each of MesaCAN's existing services to assess possible duplication of functions and to look for opportunities to leverage the other agency's programs. For example, families that seek assistance at A New Leaf's family homeless shelter are now automatically screened for MesaCAN's services, eliminating one intake process and enabling the two agencies to offer comprehensive support to families in need. MesaCAN also benefitted from A New Leaf's development staff, which gave MesaCAN access to A New Leaf's network of funding opportunities and allowed MesaCAN to start a fundraising campaign for its capital improvements needs.

Turning over MesaCAN's administrative functions to A New Leaf freed DiNolfi to focus on MesaCAN's service delivery and other critical needs of the agency. In the first two years following the completion of the affiliation, the EVMC increased the number of homeless men served by 100 individuals per year, and the Client Services/Work Assistance Program at MesaCAN served an additional 2,700 individuals per year. Under the terms of the Affiliation Agreement, A New Leaf partnered with two local funding agencies—Mesa United Way and Valley of the Sun United Way—to make an initial investment of $360,000 to renovate MesaCAN's main office building and the EVMC facility. The improvements to MesaCAN's facilities led to increased support from MesaCAN's community partners. The Arizona Department of Housing subsequently made a $500,000 grant towards additional renovations at the EVMC facility and the Mesa United Way awarded $200,000 to both agencies to further their programs.

The merger also prompted MesaCAN's Board of Directors to engage in more regular and proactive strategic planning. The agency brought in an outside consultant in September 2011 to work with the Board to develop a strategic plan based upon the root causes of poverty in its service area, and the session marked a turning point for the organization. Coming out of the strategic planning session, MesaCAN decided to focus on education, financial management and employment as its core anti-poverty strategies. One example of the implementation of MesaCAN's strategic plan has been its IDA program, which offers qualifying individuals and families savings accounts with matched funds to save towards the purchase of a home, small business ownership, or tuition payments. At the time of the merger, MesaCAN ran a small IDA program serving mostly low-income families. Following the merger and through the relationship it developed with the Mesa United Way as a result of the merger, MesaCAN began to expand the program to serve low-income students attending a local community college in order to improve college attendance and graduation rates in Mesa.

DUE DILIGENCE

A New Leaf began the due diligence process by reviewing MesaCAN's financial statements and working through a matrix of questions to assess the agency's financial and legal risks and to explore possible operational synergies. Because MesaCAN and A New Leaf operated in the same service area, both agencies were familiar with the other's programs and services. MesaCAN had also previously referred clients to A New Leaf's family homeless shelter. Further, a member of MesaCAN's Board of Directors, who was an attorney, also sat on A New Leaf's Board of Directors and played a significant role facilitating the affiliation transaction. The existing relationships between the two agencies greatly facilitated the diligence process and helped each side quickly get comfortable with the affiliation.

MERGER TRANSACTION COSTS

The costs associated with the affiliation were minimal because an attorney drafted the Affiliation Agreement on a pro bono basis.

STAFF

A New Leaf offered each MesaCAN staff member a position with the combined agency, though some were moved into different roles. MesaCAN's human resources, accounting, and business operations functions were consolidated into corresponding departments at A New Leaf. MesaCAN retained all of its employees for the first six months following the completion of the affiliation, and both DiNolfi and Hughes noted an increase in staff morale due to salary raises, more comprehensive employee benefits, and improved working spaces following the renovations of MesaCAN's facilities.

ONGOING CHALLENGES

The most significant challenge in the merger process has been securing the funding necessary to renovate and maintain MesaCAN's facilities. Both the main office building and the EVMC facility were housed in buildings previously used for industrial purposes and continue to require substantial upkeep. A New Leaf worked together with local community funding partners to pay for the initial building upgrades, but MesaCAN continues to have ongoing physical plant needs.

Another challenge for A New Leaf has been learning the language and requirements of the Community Action network necessary to run a well-functioning CAA. For example, A New Leaf initially did not understand the scope of the non-federal match requirements under the Assets for Independence (AFI) project that funds its IDA program. As a result, MesaCAN was unable to spend all of its IDA grant funds in the first year following the completion of the merger because it could not secure a non-federal match. The agencies have worked closely with the Arizona CSBG state association, which has provided regular training for staff members on the root causes of poverty and effective poverty prevention strategies.

The Boards of Directors and staff members of both agencies have had to regularly reevaluate their missions and programs in light of the CSBG Act's mandate to enable individuals and families to achieve self-sufficiency. This periodic reevaluation has led to differences in opinion regarding the direction of the agencies. Prior to the merger, A New Leaf's services had focused largely on the consequences of poverty, rather than poverty prevention. The decision to expand MesaCAN's IDA program arose out of one of the agency's strategic planning sessions, which led to a recommendation to bundle the emergency services that clients request when initially contacting MesaCAN with more long-term financial, educational and employment training programs. Not all staff members, however, have embraced the program, and some have subsequently left the agency.

LESSONS LEARNED IN THE MERGER

- **Getting early buy-in from the Boards of Directors of both agencies.** Though the initial conversations regarding a possible merger originated with the Executive Directors of MesaCAN and A New Leaf, the Boards of Directors of both agencies were deeply involved in the merger discussions from the outset. Getting a few prominent Board members on board with the transaction at an early point as advocates of the merger proved to be critical to helping the Board understand the transaction and the benefits of each agency.

- **Recognizing the unique culture of each agency and addressing potential changes in conversations about retention with employees and board members.** MesaCAN recognized that its employees were concerned about losing the unique identity and reputation the agency had developed in the city. Thus, one of the agency's priorities was to mitigate these concerns as well as address the potential changes resulting from the merger in conversations with its employees and Board members when encouraging them to join the combined agency. For example, MesaCAN decided to retain the names of its programs and physical facilities to emphasize that the agency would continue to be run as an independent entity, while encouraging employees to think about the strategic direction of MesaCAN and how they contribute to it following the completion of the merger.

- **Leveraging pre-existing relationships between individual board members to support the merger.** Both agencies found it helpful that individual members of their respective Boards had pre-existing relationships with each other. This fostered trust and confidence in the other organization's leadership and helped the agencies develop a good working relationship early on in the integration process.

- **Seeking training and assistance from the state association.** The combined agency reached out to the state association (the Arizona Community Action Association) for assistance on operating a CAA and becoming familiar with the vocabulary and practices of the Community Action network. The state association was very supportive in providing training and worked closely with the agencies to understand the requirements of the CSBG Act and best practices for well-functioning CAAs.
- **Having not just a driver of the transaction, but a champion.** While the transaction ultimately came down to a number of logistical hurdles, having a visionary for the merger who advocated for the benefit to both agencies was a key to its success.