

FINALLY

GOVERNMENT TURNS TO NONPROFITS FOR THE ANSWER: But That's Not Good!

UNLESS YOU ARE INTIMATELY INVOLVED WITH A 501(C)(3) ORGANIZATION AS STAFF OR SUPPORTER, YOU'RE PROBABLY NOT AWARE OF THE DIFFICULT TIMES MOST ARE FACING. HERE IT IS IN A NUTSHELL: THERE'S NOT ENOUGH MONEY.

AND THERE ARE 1.5 MILLION NONPROFITS COMPETING FOR THE SAME DOLLARS.

That's the good news!

by Rus Kinzinger

GOOD NEWS? In a newly released report on municipal fiscal conditions, the National League of Cities gave this sobering finding:

- More than half of city finance officers report that their cities are in worse fiscal shape in 2011 than in 2010.
- Cities reliant on the property tax were in worse fiscal shape than those reliant on the sales tax.
- Finance officers predicted a 2.3 percent decline in revenues and a 1.9 percent decrease in expenditures—the fifth straight year of municipal spending retrenchment.
- Two out of five finance officers reported that their cities had increased what they charge as fees for services; one-fourth created new fees for services; and one-fifth reported increasing property tax rates. (*Rick Cohen. "Cities Report Continuing Fiscal Distress in 2011." The Nonprofit Quarterly, 30 September 2011. 4 October 2011. <http://bit.ly/qcREXL>).*

In reporting the NLC findings, The Nonprofit Quarterly added: “. . . municipalities might aim to keep in-house federal and state pass-through funds—such as Community Development Block Grants—that they would ordinarily re-grant to nonprofit service providers and community developers.”

That's still the good news.

SAY IT AIN'T SO, JOE! As if getting scarce dollars were not already a life and death struggle for nonprofit organizations, municipalities and other units of government are becoming quite creative in identifying ways to “access” some of their resources. Seemingly inviolable even a few months ago to most of us, nonprofit assets have become fair game in an intensifying race to find new sources of funds. Not surprisingly, governmental officials say that shrinking or depleted revenues and spiking costs are the culprits.

Though diminished revenues is the seeming motivation for tapping nonprofit resources, is there an accompanying rationale for doing so? Yes. If 501(c)(3) organizations are granted tax exemptions to provide needed services—which the private sector cannot deliver at a profit—is it

not, therefore, the logical domain of units of government to rethink what services are truly needed as well as the extent to which service delivery should be subsidized? Public policy arguments to support this position have substantive merit though application of those arguments has substantial consequences.

VULNERABILITY. Nonprofits are at risk along several fronts. Perhaps best known and, therefore, seemingly most vulnerable to government's extended reach is the long-sacrosanct property tax exemption which says in essence that real estate owned by the nonprofit and used in direct provision of charitable or other exempt services is exempt from taxation. Though I do not see this principle changing ideologically, pragmatism and years of experience lead me to anticipate a number of noteworthy changes.

First, **units of government will increasingly request voluntary property tax offsets** from medium to larger organizations. This, in fact, is already happening in some areas. In a recent letter to the chief executives of 40 major nonprofit corporations, Boston city officials stated the value of each nonprofit's real estate holdings and asked them to pay up to 25% of what they would owe if their property were not tax exempt. Fortunately, Boston limited its request to larger nonprofits. A 2010 study by the Lincoln Institute of Land Policy, however, a Cambridge research institute found that nonprofit organizations have already made voluntary payments to 117 municipalities in at least 18 states. The study also reported that more cities were expressing interest in such payments.

A second change is that **units of government will actively look for ways to avoid losing revenue to nonprofits.** Let me explain. Agencies with 501(c)(3) designations frequently provide "soft" services whose outputs, i.e., products are often ambiguous, and many times quite hard to quantify. It should come as no surprise then that if the organization itself fails to adequately translate its community services into "touchable, valued, and monetized outputs," units of government will certainly not do so. In one case known to this writer, a nonprofit organization

won a bid process to buy city-owned, taxable real property in order to expand its client programs. Shortly after acknowledging that the nonprofit had won the bidding, the city reversed itself and awarded the property to two for-profit concerns *because the nonprofit's tax-exempt status would have subtracted from the municipality's tax base.* The municipality was not being malicious: it was simply acting in its own best interests. Perhaps even had the nonprofit done a better job of articulating community benefits, there might well have been a different outcome. Who knows?! What is known, however, is that under financial pressure, local units of government will most always err on the side of what best protects their revenue interests.

NO ONE ESCAPES. Though taxing the real holdings of larger nonprofits is, of itself, ominous, there are other equally real dangers which apply to *all* nonprofit organizations. One such is **establishing a higher standard of social need for granting a 501(c)(3) exemption.** Practically speaking, if appropriate legislative bodies raise the bar for statutorily addressing a social need, there will be fewer properties potentially exempt from taxation; hence, greater income to the taxing body. In an August 14, 2011 article, "California Scrutinizes Nonprofits, Sometimes Ending a Tax Exemption" *NYT.com* reported that a growing number of nonprofit groups are being denied property tax exemptions because the state's chief tax collector and assessors contend, "They do not *do* enough to benefit state residents." State budget woes are considered the likely motive.

Creative encroachment doesn't stop there, however. Nonprofit leaders in Illinois need only look at their own state government to see yet another example of how a once privileged relationship with government is under attack. To cover its revenue shortfall, state officials *borrowed* \$1.17 million in FY'11 from the tax check-off funds taxpayers gave to charity. Though all monies fronted via such means are to be repaid with interest—a process that usually takes about 6 months—many nonprofit organizations providing vital services have yet to be paid from money donated with tax forms for either 2009 or 2010.

One of my great professors from college days was quite fond of asking the question: **“Who will watch the Watchers?”** Seems somehow even more fitting that it should be asked *now*.

Illinois’ fiscal morass is so severe, however, that borrowing charity-designated funds is only one of the means by which it gains access to nonprofit dollars. By most accounts the state owes its nonprofit providers \$5 billion on 166,000 claims, including approximately \$41.9 billion from Medicaid providers. Unfortunately, given only insubstantial political pushback to this point, state initiated **deferrals in paying and/or repaying funds owed** will likely remain a common practice into the foreseeable future. Meanwhile, nonprofit organizations facing recurrent crises in cash flow management will strive to do more on less—until doing so no longer makes sense, or they assert a more forceful collective voice.

IT MUST BE CONTAGIOUS. Cross the border just north of Rockford, Illinois to see an example of how **ideology** itself will likely complicate a once secure relationship between units of government and nonprofits. In this case, Wisconsin officials said “No” to federal grant applications that “duplicated existing programs, weren’t needed, or hadn’t received enough planning.” State officials explained that they were “wary of committing to ongoing programs that would later need money from state taxpayers.” (*Jason Stein. “State declines to request or back \$9 million in health grants.” JSOnline. 3 Aug. 2011. 29 Sept. 2011. <http://bit.ly/q4r1zF>).*

Here’s the problem. Historically, 501(c)(3) organizations have frequently grown community-serving programs from federal grant initiatives with the implicit understanding that reapplication for federal funds would get state sign-off if outcome objectives were met. This assumption now appears iffy in at least one state. Though state leadership certainly has the right to change the rules of the game so to speak, there are nonetheless potentially serious consequences for a program’s stakeholders if renewal applications will not be consummated by the state.

Finally, need we even mention the President’s current Jobs Plan proposal that recommends **limiting the charitable deduction** for wealthy Americans? Considering that 10 percent of donors give 90 percent of funds, the effect of such a plan on nonprofit revenue would be chilling.

IS THERE AN ANSWER? If we are to presume, therefore, that government’s support for 501(c)(3) agencies will slowly diminish—and I think we *should*—how then are nonprofit leaders to respond? What are steps that can be taken now *before* confronted with the need to develop a response? Here are a few ideas to consider.

Be sure that program outputs have legitimate value. Peter Drucker, the father of modern management, encouraged nonprofit executives to practice *planned abandonment*, i.e., to discontinue programs that no longer meet any real public need. Drucker realized, perhaps earlier than most, that organizations frequently kept programs alive well past their usefulness. Those guilty of doing so not only waste limited resources but also weaken the very policy arguments that favor official public support. Determining real value means asking tough questions such as “Is there truly a social need that *must* be met?” “What is the true cost of *not* meeting?” “Can the benefits of meeting, or alternatively the cost of not meeting, be expressed in monetary terms?”

Express organizational outputs in understandable language. To say that ones charitable organization helps homeless veterans find work is quite different than stating that “During the past 18 months, XYZ Agency helped 115 homeless veterans find work of whom 55% have been in the job for more than 8 months and 10% have received a pay increase of \$0.25/hour or more in that time.” The first statement is self-serving at best: the latter, a quantifiable statement with some degree of organizational value. Guess which makes it easier to justify program worth to governmental officials who argue that there are better ways to spend tax dollars.

Discard the non-essential. I am always surprised to see how quickly “essential” program components (services, materials, personnel)

become “non-essential” when the right incentives are introduced. The manager of a business I once worked with believed that she was operating quite efficiently and productively until her boss introduced a profit-based incentive into her compensation mix. Almost immediately, she discovered that by cutting \$1 dollar from expenses she had greater impact on profitability than \$1 dollar added to revenues. Not surprisingly, she noticed also that certain costs she once thought necessary could be eliminated easily. For this manager, the whole process of store management quickly got exciting—and financially rewarding.

Champion the organization’s “community value” at every opportunity. Network extensively with key decision makers. Now is not the time to be shy about the good your organization does. Develop an elevator speech that states what the organization does; then, work it into even the most mundane conversation. Perhaps start with the mission statement and go from there. Remember always to express in language that the *listener* will understand. Now is not the time for deftly crafted phrases that mean nothing to anyone but agency insiders. You need supporters who understand why the organization is necessary. Get real, get passionate, get busy, get talking.

Look for new ways to be of service to the community—especially it is struggling financially to provide basic services. In California, for example, several nonprofits joined together to seek permission from the governor to run the state’s parks that were closed due to fiscal insolvency. Examples do not need to be of such scale to be relevant, however, and might include proposals to pick up trash in city parks, mow abandoned properties, maintain city-owned cemeteries, clear snow from downtown sidewalks, or any other number of services at lesser cost than the municipality could provide on its own. Of course, any such initiative should be mission-compliant and make financial sense for the nonprofit. Also, if approved, the nonprofit may need to organize a subordinate business to operate under the flagship of the primary organization. It is worth noting, however, that any

resulting inter-organizational partnership would *of itself* help position the nonprofit as more contributive to community solutions than either costs, or revenue shortfalls. In a milieu where perception and political context often defines which organizations live and which die, good feelings go a long way in survival strategies.

Start a business. Though launching a business may *sound* glamorous, doing so involves both specific competence and *risk*. Too, the latter is often controlled by official agency policy that states a degree of risk the 501(c)(3) is willing to assume. Don’t get a head of yourself. Be planful and careful at every stage. Get counsel as needed. Cautions recognized, however, prudent leadership will look at earned income options to supplement revenue losses from the intrusions I have been describing.

Get politically involved. I am not suggesting party-sidedness, rather, that you develop a working relationship with key political players. It is, after all, your responsibility to the public—and especially those served by the organization—to represent their interests as broadly and deeply as feasible. Conversational familiarity with local, state, and federal legislators is certainly a reasonable fulfillment of that duty. Then again, the more intimately aware pols are of the organization’s specific, positive, and quantifiable contributions to the community, the less likely they are to go after its resources. Remember, it is also a cost and benefits thing. When the value of an existing 501(c)(3) is clearly established, articulated, and communicated, the bar for tapping its resources is raised appreciably.

Demonstrate financial stewardship. If your nonprofit appears extravagant, you might as well write the check because it’s going to pay! Fidelity to the stakeholders, donors, and taxpayers requires that dollars be leveraged optimally to the benefit of those served. Glitz never speaks well to a careful stewardship of entrusted funds. It is ALWAYS a red flag.

Network extensively with other nonprofits. Merge where possible. Share resources broadly. Leaders who have somehow missed that times

have changed are going to find their organizations on the short end of revenues more often than not. And it's my best guess that almost nothing of the not-for-profit world will remain untouched by what history will surely record as a tectonic shift in programming, resource utilization (including staffing), technology, and revenue generation. Future-focused nonprofit executives, and the Boards in charge of their organizations, will do well to adopt a "Do more with less" *modus operandi*. They might even discover that they *can*.

AND SO . . . If there is any desired takeaway from this article, I hope it is this: that nonprofit leaders recognize the need to operate from a different set of resource assumptions. The once cozy relationship with government and its quasi-protectionist practices are soon to become a matter of history, by necessity. It's all about money and where it can achieve the greater good—nearly always as defined by units of government.

Importantly, the aware reader will see nothing in this discussion that is not affirmed already in Section 125 of the IRS Code that creates nonprofit

organizations. What the reader *will* see is a renewed call for nonprofit leadership to become diligent about what it is the organization *does* and *accomplishes*. It is my sincere belief that if the organization's output addresses a legitimate social need, and if what it accomplishes is validated, clearly articulated, and broadly communicated, the future will not look nearly so ominous as I have painted. Here's hoping so! –R.K.

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