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Revenue Prospects for New York City's Nonprofits:

Scenarios of WTC and Recession Impacts

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INTRODUCTION

The current revenue outlook looks particularly bleak for many of New York City's nonprofit organizations. The revenue problems are both short- and long-term. The most serious immediate issues are the lingering short-term effects of the September 11 WTC tragedy, the current recession, and the anticipated cutbacks in government programs that contract to nonprofits for delivery of services. Their continuing ability to provide health, educational, cultural, and social services to the city's residents is threatened at a time of increased need and demand for services.

While specific information is not yet available about the anticipated revenue shortfalls and their incidence of impacts, estimates are needed now to assist nonprofits in their budgetary planning. Several years from now we will know a great deal "retrospectively" about the current revenue crisis for New York's nonprofits, the increased level of demand for many nonprofit services, and the impact of selective revenue shortfalls on service users. However, some information on projected revenues, even if only based on rough projected estimates, could be immensely useful now for funders, policy officials, and advocacy and lobbying groups. Our objective here is to provide a framework of revenue projections for New York City's nonprofit sector that reflects current best estimates.

Although precise and comprehensive information on revenue prospects and their impacts on service provision is not yet available from official documents or survey findings, significant clues have began to emerge from preliminary reports. Nonprofit revenues from all the traditional sources, i.e. charitable contributions, service fees, and endowment income, are likely to shrink significantly in the coming year. Furthermore, declines are anticipated next year among all sources of contributions, i.e. individual gifts, corporate donations, as well as foundation grants. Revenues earned by nonprofits from fees and sales of services (including government reimbursements and contracts) are expected to decline as well, as federal, state, and local government agencies are cutting back on their expenditures for contracted programs. The other major category of nonprofit revenues, money earned from investment of endowment funds, will also be disappointing because of the weak performance of financial markets. The aggregate effects of this combination of revenue losses will likely translate into year-end budget deficits for many nonprofits and some curtailment of the health, educational, cultural, and social services that nonprofits provide, especially to the city's most vulnerable population.

Whereas nonprofit revenues did benefit from the upsurge in charitable gifts during the 1990s and the greater availability of government grants and contracts, the longer-term financial picture for New York City's nonprofits is highly problematic. This is especially true among agencies providing health and social services to the city's most vulnerable residents. The revenue of these agencies is highly sensitive to federal, state, and municipal funding for contracted programs, the ups and downs in New York City's private sector economy that affect donations, and investment returns on their own endowments and those of their foundation supporters.

Added to these shorter-term revenue issues that currently threaten the financial viability of the city's nonprofit organizations are serious longer-term and structural problems. The major sources of concern stem from: the greater dependency on revenues from service fees; declining shares of revenues from charitable contributions and foundation grants; and the greater prevalence of government contracts to deliver services that do not compensate nonprofits for the full costs of providing the services. The consequences for many of New York's nonprofits has been depletion of reserve funds and greater likelihood of year-end budget deficits at a time when reserves are needed most.

Discussions with nonprofit leaders point most frequently to expected reductions of **fifteen percent** in nonprofit revenues from contributions, earned income, and investments. Other scenarios can be provided using the same methodology. Of course, we should not expect that all nonprofits are likely to experience a uniform fifteen percent reduction in their revenues. They differ a great deal in the share of their income that is derived from these major revenue sources. They also differ in their levels of reserve funds that can be applied to year-end deficits. Projections are necessarily more valid and useful when based upon the diversity of baseline financial conditions among nonprofit organizations and their variations in revenue sources.

The analysis and projections in this report utilize baseline data for 2000-01 from a recently completed comprehensive inventory of New York's 8,000 major nonprofit service providers. These baseline data are the figures provided by the nonprofits on their IRS 990 forms supplemented by survey responses from more than 3,000 of the nonprofits. The initial section of this report includes the essential baseline financial information. A more complete description of the data, methodology and findings from the study can be found in the publication, *New York City's Nonprofit Sector* (see the www.nycnonprofits.org website for further details).

NONPROFITS' FINANCIAL CONDITION IN THE 2000-01 BASELINE PERIOD

Budget Surpluses and Financial Vulnerability Prior to 9/11

Many of New York City's nonprofits were financially vulnerable even before the WTC disaster and the current recession. The 7,995 major nonprofits that provide services in New York City had total revenues of about $43.6 billion in the 2000-01 fiscal year and total expenditures of $39.5 billion, yielding an aggregate positive balance of about $4 billion that could be added to reserves and endowment (refer to Table 1, last three columns).

TABLE 1
Baseline Financial Information, Nonprofits Classified by Service Sectors ($millions)

Service Sector	Assets $	Contributions Revenue $	% of Total	Service Fees Revenue $	% of Total	Investment Revenue $	% of Total	Total Revenue $	Total Expenditures $	Net Revenue $
Arts (N=1,629)	6,359	1,148	45	907	35	511	20	2,565	1,920	645
Education (N=944)	17,807	2,411	28	5,122	59	1,175	13	8,709	7,117	1,591
Health (N=907)	17,188	3,410	15	17,647	80	953	4	22,010	21,184	826
Human Services (N=2,321)	4,402	2,537	45	2,940	52	191	3	5,668	5,294	374
Housing Dev. (N=338)	88	107	31	222	64	19	5	348	326	23
Public Benefit (N=1,273)	4,170	1,334	46	1,283	45	260	9	2,877	2,533	344
Supporting Orgs. (N=137)	1,631	489	64	175	23	97	13	762	626	126
Religious Affiliated (N=446)	1,258	280	41	367	54	34	5	680	547	133
Total (N=7,995)	52,903	11,716	27	28,663	66	3,239	7	43,618	39,546	**4,062**

Source: Baseline data from Core and Digitized Files of IRS 990 returns, 2000-01.

The year-end surpluses were, however, not evenly distributed among the organizations. Most of the budget surpluses were confined to universities, research institutions, museums, and other large organizations with active capital campaign drives. Nonprofit organizations with surpluses tended to have larger assets, greater shares of revenues from earned income and contributions, and a smaller share of budgets devoted to administrative expenses. Thus, among the nonprofit *service sectors*, arts, education, and public benefit organizations had higher budget surpluses relative to their total revenue, while health, housing development, and human service organizations reported very modest year-end balances. When nonprofits were classified according to their primary activities, only the "amenity" category (principally arts, cultural, and higher education organizations) had significant year-end surpluses relative to their annual expenditures (refer to Table 2).

TABLE 2

Financial Information, Nonprofits Classified by Activities ($millions)

Special Orgs.	Assets $	Contributions Revenue $	Contributions % of Total	Service Fees Revenue $	Service Fees % of Total	Investment Revenue $	Investment % of Total	Total Revenue $	Total Expenditures $	Net Revenue $
Amenities (N=1,355)	21,422	2,922	32	4,747	52	1,505	16	9,174	7,198	1,976
Social Services (N=2,101)	6,184	2,624	30	5,739	66	353	4	8,715	8,170	545
Hospitals (N=87)	12,089	1,889	13	12,425	84	511	3	14,824	14,525	299
Housing (N=418)	183	156	34	277	61	21	5	454	424	29
Crisis Intervention (N=165)	374	324	44	392	54	15	2	731	712	19
Religious Affiliated (N=443)	342	205	45	227	50	21	5	453	407	47
Total (N=4,569)	40,593	8,119	24	23,807	69	2,424	7	34,351	$31,436	**$2,915**

Source: Baseline data from Core and Digitized Files of IRS 990 returns, 2000-01.

Baseline Deficits

Prior to 9/11, twenty-nine percent of all the nonprofits had a year-end deficit while nineteen percent had deficits greater than $10,000, the same share as was reported in a 1990 study (see Tables 3a and 3b).[1]

TABLE 3a
Baseline Deficits, Nonprofit Service Sectors (%)

Service Sector	Share with Baseline Deficit (%)
Arts	30
Education	25
Health	30
Human Services	26
Housing Development	55
Religious Affiliated	29
Public Benefit	29
All	29

TABLE 3b
Baseline Deficits, Nonprofits Classified by Activities

Special Organizations	Share with Baseline Deficit (%)
Amenities	34
Social Services	34
Hospitals	31
Housing	51
Crisis Intervention	35
Religious Affiliated	29

Source: Baseline data from Core and Digitized Files of IRS 990 returns, 2000-01

Previous analysis of the financial information and the survey data reported in *New York City's Nonprofit Sector* revealed that budget deficits tend to be higher among organizations with fewer assets and those more dependent on earnings from investments (i.e., interest and dividends that experienced some decline during the year). Deficits tend to be higher in organizations that spend little on fundraising. Finally, deficits were more common among nonprofits that focus on poverty groups and immigrants. Budget surpluses, on the other hand, tend to be higher for nonprofits whose clients are white, children and teenagers, and the elderly.

Twenty-three percent of the nonprofits had combined assets in facilities, office equipment, and reserve funds that totaled less than $10,000. Year-end budget deficits were much more common among organizations in the housing development sector (55%) and least common among those providing educational services (25%) (see Tables 3a and 3b).

<u>Diversification of Revenue Sources</u>

Nonprofit organizations have generally been able to diversify their sources of revenue. Some organizations are naturally more dependent on certain kinds of revenue, like hospitals which rely heavily on government grants and reimbursements. Contributions accounted for $11.7 billion (or 27% of all revenues in the nonprofit sector as a whole) in the baseline period, while earned income added $28.7 billion (66%), and investment income totaled $3.2 billion (7%) (refer to Table 1). However, the *average* nonprofit organization (which is weighted heavily by the many smaller groups) received 53% of its income from contributions, 43% from earned revenue sources, and 6% from investments. Reliance on contributions was highest among public benefit, arts, and human service organizations and least among the health providers (who received more than 80% of their income from service fees and contracts). Note that religiously affiliated agencies and those that target their services to crises are especially dependent on contributions (refer to Table 2).

Government funding of New York City's nonprofits in the form of grants, contracts, and reimbursements was very substantial during the baseline year. The shares of revenues from all government sources was 64% among human service providers, 72% in housing development, and 41% among hospitals and other health care providers, as opposed to 30% in the education sector, and only 11% in the arts (refer to *New York City's Nonprofit Sector*, Table 5.2 and accompanying text).

SCENARIO ANALYSIS

The scenario analysis of anticipated revenue losses is based upon estimated cuts of 15% in major revenue sources, but projections can be made on the basis of other estimates of cutbacks. The repercussions of these cutbacks are measured by their effects on nonprofits' year-end revenue surpluses or deficits (i.e., net revenue for the year or the difference between total revenues and expenditures). Refer to Tables 4a and 4b for projected estimates of the share of nonprofits with revenue losses, by service sector and activities. Tables 5a and 5b show more detailed estimates for selective types of revenue losses by service sector and activities of nonprofit organizations.

TABLE 4a
Baseline Deficits and 15% Scenario, Nonprofit Service Sectors

Service Sector	Share with Baseline Deficit (%)	Share with Deficits if 15% Reduction in: Total Revenue %	Contributions %	Service Fees %	Investment %
Arts	30	59	47	46	31
Education	25	56	38	47	27
Health	30	79	1	66	0
Human Services	26	84	48	65	28
Housing Development	55	78	1	72	1
Religious Affiliated	29	66	54	42	33
Public Benefit	29	73	52	44	33
All	29	71	48	54	32

Source: Baseline data from Core and Digitized Files of IRS 990 returns, 2000-01.

TABLE 4b
Baseline Deficits and 15% Scenario, Nonprofits Classified by Activities

Special Organizations	Share with Baseline Deficit (%)	Share with Deficits if 15% Reduction in: Total Revenue %	Contributions %	Service Fees %	Investment %
Amenities	34	67	54	54	36
Social Services	34	79	60	60	37
Hospitals	31	81	54	80	38
Housing	51	79	61	68	53
Crisis Intervention	35	88	72	64	41
Religious Affiliated	29	67	54	42	33

Source: Baseline data from Core and Digitized Files of IRS 990 returns, 2000-01.

We assume in the projections that most nonprofit organizations are not effectively able to pare their expenditures in the short-run. Expenditures prominently include administrative costs (management salaries, rent, equipment, etc.) and service related expenses (chiefly wages and benefits for service personnel) that are difficult to reduce quickly even when revenue levels are highly uncertain. Those nonprofits that are highly dependent on revenues from operating programs cannot cut back their expenses without further curtailing their income from service fees. Nonprofits fortunate enough to have reserve funds or endowments are better able to survive short periods of disappointing revenues without significant reductions in their operating programs. Those less fortunate turn to short-term borrowing, but eventually must cut expenditures if revenues do not recover very quickly.

Reduction in Total Revenues

In the event that total revenue from all sources is reduced by 15% (i.e., by $6.55 billion), the $4 billion surplus recorded for the nonprofit sector in 2000 would turn to a deficit of almost $2.5 billion if expenditures were not curtailed (see final column in Table 5a).

TABLE 5a
Financial Information and Scenario Estimates, Nonprofit Sectors ($millions)

			Net Revenue with 15% Reduction in:			
Service Sector	**Number**	**Baseline Net Revenue $**	**Contributions $**	**Service Fees $**	**Investment $**	**Total Revenue $**
Arts	1,629	645	473	509	568	260
Education	944	1,591	1,230	823	1,415	285
Health	907	826	314	-1,821	683	-2,476
Human Serv.	2,321	374	-7	-67	345	-476
Housing Dev.	338	23	6	-11	20	-30
Public Benefit	1,273	344	144	152	305	-87
Supporting Orgs	137	126	53	100	112	12
Religious Affil.	446	133	91	78	128	31
All	7,995	4,062	2,305	-237	3,576	**-2,480**

Revenue scenarios of impacts on net revenues based upon 15% reductions in each category and total revenues.
Source: Baseline data from Core and Digitized Files of IRS 990 returns, 2000-01.

Almost three-fourths (71%) of the nonprofits would be operating with deficits and more than half (52%) would have year-end deficits greater than $10,000 (refer to the "total revenue" column in Table 4a). Virtually all of the $2.5 billion deficit according to this extreme scenario would occur in the health sector (see Table 5a) and more specifically among the city's hospitals whose reserve funds are relatively very low (Table 5b).

TABLE 5b

Financial Information and Scenario Estimates, Nonprofits Classified by Activities ($millions)

			Net Revenue with 15% Reduction in:			
Special Organizations	**Number**	**Baseline Net Revenue $**	**Contributions $**	**Service Fees $**	**Investment $**	**Total Revenue $**
Amenities	1,355	1,976	1,538	1,264	1,750	600
Social Services	2,101	545	151	-316	492	-762
Hospitals	87	299	16	-1,564	223	-1,924
Housing	418	29	6	-12	26	-39
Crisis Intervention	165	19	-30	-40	17	-91
Religious Affiliated	443	47	16	13	44	-21

Revenue scenarios of impacts on net revenues based upon 15% reductions in each category and total revenues.
Source: Baseline data from Core and Digitized Files of IRS 990 returns, 2000-01.

<u>Reduced Contributions</u>

If contributions alone were to decline even by 15% (i.e., by $1.76 billion, thereby shrinking net revenues from $4.062 billion to $2.305 billion), other revenues stayed constant, and the losses in contributions were not made up through reduced expenditures, an estimated 48% of all New York City's nonprofits would be operating at a deficit and 36% would have deficits greater than $10,000 (Tables 4a and 5a). The breakdown by service sector shows that these levels would be much higher among religiously-affiliated groups (71% with some deficit and 57% with a deficit exceeding $10,000) and housing development organizations (61% and

56%, respectively) (refer to Table 4b). Among the specialized organizations, the crisis services group would be hardest hit (see Tables 4b and 5b).

Reduced Earnings from Service Charges

If earned revenue were to decline by 15% (i.e., $4.3 billion) because of declines in service charges, membership fees, ticket revenues, tuition payments, government contracted services, etc., then more than half (54%) of the City's nonprofit organizations would be operating at a deficit; and more than a third (34%) would have budget deficits greater than $10,000 (see Tables 4a and 5a). The nonprofit sector as a whole in this case would have a deficit of $237 million instead of the surplus of $4 billion recorded for the year 2000 (see Table 5a). Impacts would be most severe with the health, human services, and housing development groups (see Tables 4a and 5a).

Reduced Income from Investment

If investment income were to decline by 15% (i.e. by $500 million) because of reduced earnings from endowments and other investments, then the share of organizations with deficits would increase from 29% to 32% and those with deficits greater then $10,000 would increase from 19% to 20%. The impacts would be more severe among supporting organizations and those in the housing development sector (see Tables 4a and 5a).

Revenue Prospects

These scenarios are quite plausible especially for organizations that suffered uncompensated losses in revenues in the aftermath of 9/11 or have been affected by New York City's recession, stock market declines, and reduced revenues from government contracts and grants. Anecdotal information suggests, however, that selected cutbacks have already been made by many nonprofits in their expenditures, especially for staff, in anticipation of reduced revenues.

The surveys were administered prior to the WTC tragedy and the current recession, but the findings reveal a good deal about the concerns that nonprofits had about their revenue base as of late 2000 and early 2001. Respondents were asked if they expected that revenues would decline or increase, by how much, and why; how changes in revenues from various sources have affected their service provision; and what they had already done to cope with revenue pressures (including hiring fundraisers, embarking on joint ventures, etc.).

Sixty percent of respondents thought that their revenues would stay relatively even in the following fiscal year, 26% estimated an increase greater than 10%, and only 5% believed revenues would decline by more than 10% . The supporting and human service organizations were the most optimistic about revenue prospects and the health, arts, and housing development organizations were the most pessimistic. A much higher share of the smallest organizations (i.e., those with budgets between $25,000 and $100,000) were uncertain about next year's revenues). A higher proportion of the largest organizations with budgets above $10 million ventured that expected revenues would stay relatively even.

Respondents affirmed that their ability to provide services was very closely tied to *foundation and government grant* levels. Increased funding from these sources has enabled the organizations to expand service levels and declines in funding from these sources have led to some service reductions, although not to the same extent. More than 20% of organizations suggested that those who use their services are sensitive to the fees charged for the services.

<u>Revenue Alternatives</u>

New York City's nonprofits were actively seeking solutions for their revenue problems even before the WTC tragedy and current recession. More than half (55%) had applied for government programs within the past two years that had not funded them in the past, especially among housing development and human service organizations, and 84% turned to new sources in the foundation and corporate donor community. Almost 29% of organizations reported greater reliance on fees or user charges, especially in the education sector. The arts sector reported the highest increase in sale of goods (20% of organizations versus an average of 10% for all sectors).

Only 5% of all nonprofits set up a for-profit subsidiary or embarked on a joint venture with for-profit organizations, but the shares were much greater among housing development, public benefit, and supporting organizations. However, almost 20% of nonprofits initiated joint ventures with other nonprofit organizations, especially among housing development and public benefit groups. Human service, education, and arts organizations were the least likely to experiment with these joint ventures.

Almost 20% of nonprofits hired outside fundraising specialists and an additional 18% hired in-house fundraising staff, especially among the larger housing development, education, and public benefit organizations. Furthermore, almost one-third of the nonprofits (and a higher share of the largest organizations) held new special events to raise funds in the past two years.

Changes in management practices have also been initiated in the past two years by many nonprofits. Almost half of all nonprofits (46%), and greater numbers in the health sector, implemented new management practices. Half developed strategic plans (reaching almost 90% among housing development nonprofits).

There is some clear evidence of nonprofits reaching out to assist one another with revenue issues. Seventeen percent of nonprofits increased their cooperation with other agencies in purchasing, use of staff, etc., and a further 13% merged or partnered with other organizations. Again, housing development and health groups have been most active in these efforts.

Revenue concerns have also led more than forty percent of many nonprofits to increase their reliance on use of part-time employees and volunteers. Housing development, arts, and education organizations have been most active in the use of part-time employees and health organizations have resorted to part-timers to a lesser degree. On the other hand, supporting organizations as well as arts and human services have been turning more to volunteers, a tendency which is less common with health, housing, and public benefit groups.

As might be expected, an increase in reliance on volunteers is more prevalent among smaller organizations, whereas the nonprofits with larger budgets were more inclined to undertake strategic planning, implement new management structures, and augment their cooperation or merge with other organizations.

DISCUSSION AND SUMMARY

Nonprofits have a dominant role in providing social, health, arts, and educational services to New Yorkers. They also maintain the infrastructure of facilities and staff expertise that ensures continuity in the capacity to meet the service needs of local residents in good and bad times. In normal years, diversified revenues from contributions, service fees, government contracts, and endowments enable most nonprofits to meet their service costs, although many smaller social service agencies that serve low income residents fall behind in their annual budgets. During the current crisis period, revenues from all major sources are likely to fall at a time of substantially increased service demand. The revenue shortfalls challenge not only the ability of nonprofits to augment, or even maintain, current service levels but also threaten the infrastructure of facilities and trained personnel.

The scenarios of an anticipated fifteen percent decline in revenues demonstrate a mix of likely outcomes for nonprofits that vary by sector and access to reserve funds and borrowing power. Impacts are likely to be most severe among the nonprofit hospitals and the smaller social service agencies that do not fall under the umbrella of federated fund raising organizations. Additional survey analysis are needed and will be carried out in the Fall of 2003 to verify the projected revenue declines and to determine the measures that nonprofits have adopted, or plan to implement, to control or cut back on expenditures and service levels.

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[1] Deficits were computed from two-year moving averages because receipt of revenues does not always coincide with the more regular timing of expenditures.