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Struggling to Stay Afloat

By Suzanne Perry

Christine Brown recently called her local United Way with an urgent request: Do you provide emergency grants to charities that are facing hard times because of state budget cuts?

Ms. Brown co-chairs the board of A New Leaf, a small nonprofit florist and garden shop in Providence, R.I., that hires and trains adults with psychiatric disabilities. Rhode Island, like many other states, faced a hefty revenue shortfall when it put together its budget for the 2009 fiscal year — and it wielded an ax to many social programs.

Effective July 1, the annual state grant to A New Leaf was cut in half, to \$57,500. The United Way of Rhode Island could not provide emergency funds, so the group is now scrambling to find other ways to stay afloat. “You just can’t swallow this kind of cut this quickly,” says Ms. Brown.

It may be small comfort, but A New Leaf is not alone. Charities across the country are feeling the squeeze as the economic downturn — including the burst of the housing bubble, which has cut into sales-tax revenues — eats into state finances.

Rhode Island was among 29 states, plus the District of Columbia, that in total faced an estimated \$48-billion in shortfalls as they put together their budgets for the 2009 fiscal year (which for most states began on July 1), according to a tabulation by the Center on Budget and Policy Priorities, a think tank in Washington. The magnitude of the gap, as a percentage of each state’s 2008 general fund, ranged from small (0.9 percent in Connecticut, 1.6 percent in Oklahoma) to huge (21.3 percent in California, 17.8 percent in Arizona), the center found.

Most states have now adopted their 2009 budgets — closing shortfalls by cutting spending, increasing taxes, or dipping into reserves. But some are still struggling, notably California, where Democrats favor taxes on the wealthy and Republicans favor spending cuts as the way to eliminate a \$15.2-billion gap.

That impasse itself has taken its toll on charities that depend on state contracts, such as Crystal Stairs, in Los Angeles, which funnels state money to child-care providers for subsidized services. In the absence of a 2009 budget, state payments to the group were frozen on July 1.

Crystal Stairs is now negotiating with its bank to take out a loan for about \$10-million so it can continue to pay the day-care providers.

Holly J. Mitchell, the group’s chief executive, says this is not the first time a delayed budget accord has forced her group to take out a loan, with no reimbursement from the state for the interest paid. But she is worried about how long the stalemate will last this time.

“The hole is so deep,” she says, “there are fewer and fewer options on how to get out of it.”

‘Negative’ Trend

California’s situation may be extreme, but the hole is indeed getting deeper for many states. The collapse of the housing market has cut into sales-tax revenues from goods such as furniture, appliances, and construction materials; a growing number of states are plagued by weak manufacturing activity; and stock-market plummets are cutting into taxes on investment income.

“The underlying trend for states is negative; budget cuts and other gap-closing methods likely loom ahead,” says a report on state revenues issued this month by the Nelson A. Rockefeller In-

stitute of Government at the State University of New York. States will feel this year's stock-market decline when they collect income taxes in spring 2009, meaning problems for 2010 budgets. "This time next year could be quite gloomy," the report says.

The study found that state tax collections during the first quarter of 2008 rose only 1.7 percent over a year earlier — and that sales-tax revenue failed to grow for the first time in six years. Meanwhile, inflation for state and local government purchases rose by 6 percent, far higher than the 2.2 percent for the economy as a whole.

In February, the report says, the economies of 10 states — as measured by labor conditions like unemployment, wages and salaries, and average hours worked in manufacturing — had declined over the previous three months. By May, the number had jumped to 36.

State officials offer no better news. In their most recent twice-yearly report, issued in June, the National Governors Association and National Association of State Budget Officers called the 2008 fiscal year a "turning point," with a significant jump in states reporting revenue problems. Governors were expecting to propose only a 1-percent increase in general-fund spending for 2009 — the third-lowest increase in the past 31 years, the report said.

The fiscal crises have hit some charities hard. In New York, the 211 hotline, which refers people in need to groups that can help them, became the victim of wrangling among lawmakers to close a \$5-billion budget gap. State money for the program, operated by regional United Ways and the New York State Alliance of Information and Referral Systems, was slashed by more than 90 percent, to \$500,000.

Susan K. Hager, president of United Way of New York State, in Albany, says the cut is a huge blow to the regional call centers, which rely on state money to cover between 30 percent and 50 percent of their costs. "We need the state as a partner," she says. "This is not discretionary, throwaway money."

The 211 program may have to forgo plans to expand service to the entire state or cut back on the hours it is available, Ms. Hager says. But she still hopes to restore the state money and is seeking an appointment with the state's new governor, David Paterson.

In Florida, which has no state income tax and has been battered by lower sales-tax revenue, arts groups are reeling from a cut of about 50 percent to the state Division of Cultural Affairs' grants budget in 2009, to \$6.3-billion. The money goes to museums, orchestras, theaters, and other nonprofit arts organizations.

To make matters worse, one day after signing the budget into law in June, Gov. Charlie Crist ordered state agencies to hold back an additional 4 percent from their 2009 spending in case revenues deteriorate further.

Sherron Long, president of the Florida Cultural Alliance, an advocacy group in West Palm Beach, says it is difficult to persuade lawmakers during tough economic times that cultural activities are essential. But a statewide network of arts groups is gearing up to make the case to candidates in next November's election that the arts can help stimulate the economy by creating jobs, drawing tourists, and educating students, she says.

Years With No Gains

While some charities took a sudden hit this year, others say their main problem is that state spending has been stagnant for several years, while their costs have increased and the need for social services for people who are suffering from the economic downturn has grown.

"Something that's really evident to me, working with many nonprofits, is the kind of slow death by strangulation, the cuts that don't make the headlines because they're not one huge swipe," says Dana Wolfe Naimark, president of Children's Action Alliance, in Phoenix.

Ms. Naimark, whose state had to close a \$2-billion gap in its 2009 budget, recently appealed to foundations to help. In a presentation to the Arizona Grantmakers Forum, an association of foundations, she said Arizona has privatized most of its health and human services, paying nonprofit groups to deliver them. However, the contract rates are below the actual cost to provide the services and are not increased on a regular basis.

She urged the grant makers to ask their grantees about state budget cuts and demand for their services; offer them grants for operating expenses; and provide them with people who can help in areas like

design, printing, accounting, and managing Web sites.

Says Ms. Naimark: “Philanthropy — foundations and individual philanthropists — cannot accomplish their goals if government is not functioning, if it’s deteriorating, falling apart, if it’s dysfunctional.”

Catholic Charities of the Archdiocese of Chicago laid off 75 of its 2,300 staff members effective this month and closed four early-childhood centers.

The Rev. Michael Boland, the group’s administrator, said it is getting harder to provide government-funded services because the amount of both state and federal grants — which make up about \$130-million of its \$170-million budget — has remained roughly the same for about six years while costs like gas and health insurance have skyrocketed.

Things could get even worse once Illinois adopts its 2009 budget. The Legislature and governor were still at odds in mid-July, but the charity expects lawmakers to cut a \$2-an-hour increase for adult day-care services and some money from the Meals on Wheels program that serves food to the elderly.

A study last year by the Rockefeller institute suggested that charities may have to adjust to a new era of reduced state spending. During the late 1990s and early 2000s, states began spending less money on cash assistance to needy people and more on social services like child care, job help, and energy assistance — bolstered by federal grants and increased tax revenues, it said.

But in 2002, for the first time since the early 1980s, state and local spending per poor person on such social services started falling. It fell each year through 2005, then, according to an update set to be published later this summer, remained level in 2006.

With federal grants to states falling in real terms, and state tax revenues shaky, the situation is not likely to improve — and that could mean some charities will go out of business, says Thomas Gais, co-director of the Rockefeller institute.

“I do think there’s going to be a shakeout,” he says. “I don’t know who’s going to get shaken,

but I just don’t know where the money’s going to come from.”

Charities are also competing for money as states devote an increasing share of their budgets to health care. Governors reported they were planning to propose increased state spending on Medicaid, the state-federal program for low-income people, by 4.4 percent in 2009 — compared with only 1 percent for the overall general fund, according to the report by the governors and state-budget-officer associations.

Furthermore, almost one-half planned to propose increasing coverage for people without health insurance, it said.

Some Exceptions

Not all states are hurting this year. States like Alaska, Montana, and Texas are benefiting from high energy prices, and others like North Dakota from high farm prices. In some states, lawmakers closed budget gaps without drastic spending cuts, but charities worry about next year.

In Minnesota, for example, the 2008-9 biennial budget agreement was mixed for social services, says the Minnesota Budget Project, a research group created by the Minnesota Council of Nonprofits. Lawmakers cut all grants from the Departments of Human Services and Health by 1.8 percent. But they also allocated money for long-term homelessness, food banks, and a cost-of-living increase for nursing-home payments.

But Gov. Tim Pawlenty, a Republican, was elected on a “no new taxes” pledge, so the lawmakers closed a \$935-million gap by cutting spending and tapping other pools of money. For example, they took \$500-million from the state’s budget reserve, half of the total, and a \$50-million loan from a special fund designed to provide health insurance to poor Minnesotans.

That, says Christina Wessel, deputy director of the project, will do nothing to head off projected shortfalls for the 2010-11 budget.

“We’re anticipating a deficit,” she says. “We’re using so many of our one-time resources and still have a governor who refuses to raise taxes. Talk about a rock and a hard place.”

The state belt-tightening is prompting some charities to rethink the way they operate. Father Boland of Catholic Charities says his organization’s

long-term goal is to cut the share of its budget that comes from federal and state money from more than 70 percent to about 50 percent, revving up its private fund raising.

United Way of Rhode Island set up a fund last year to encourage more charities to think about merging.

“There are far too many nonprofits in the state of Rhode Island for the size,” says Hank Sennott, the United Way’s vice president of communications. “Clearly one of the results of these budget cuts may be that these organizations are looking at each other: Can we combine our backroom operations, for example?”

A New Leaf, the flower shop that lost half of its state grant, is exploring whether it can do just that. One possible merger candidate is the Cookie Place Cafe, a nonprofit bakery and restaurant in Providence that also hires and trains people with psychiatric problems, says Ms. Brown, the board co-chair at

A New Leaf. But the prospect until now has seemed too daunting given the different work environments.

“Cookie Place gets hot, flowers need to be cold,” she says. “But, believe me, we’re in a frame of mind to be really creative now in a way we never did before.”

Foundations should be doing more to help charities merge, a process that can be quite complicated legally and practically, says Doug Sauer, chief executive of the Council of Community Services of New York State, an association of charities.

He says charities should also consider saying no to government money if it doesn’t cover the cost of providing the service — and should look beyond their own situation to help states find ways to balance their budgets.

“We tend to complain about what we’re not getting and we don’t tend to propose solutions to the issue,” he says.