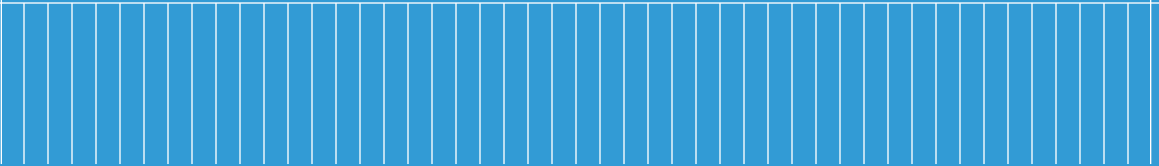


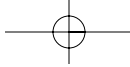
Grant Oliphant • Gregg Behr • Kate Dewey • Carolyn Duronio



# A GENEROUS GIFT

THE VALUE OF  
NONPROFIT ORGANIZATIONS  
TO OUR COMMUNITY



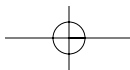


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# A GENEROUS GIFT

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THE VALUE OF  
**NONPROFIT ORGANIZATIONS**  
TO OUR COMMUNITY



## CALL IT “A TALE OF TWO FLOODS.”



After a tsunami wreaked havoc across the northern Indian Ocean in December, the U.S. government responded with a commitment of financial aid totaling, eventually, \$350 million. Within weeks, though, the amount of America’s collective response had more than doubled, as private citizens across the nation reached into their pockets and exceeded the generosity of their own government, pouring more than \$400 million into nonprofit organizations supporting the international relief effort.

Much closer to home, on a significantly smaller scale, something similar happened after Hurricane Ivan brought severe flooding to the Pittsburgh region last September. Agencies of government were on the scene quickly, but so were volunteers and area nonprofits: offering food, shelter and medical attention; helping victims clean out their homes and navigate governmental relief programs; even replacing damaged furnaces so houses would be habitable for winter. And to keep neighborhoods economically vital, a group of area foundations worked with Allegheny County to commit \$2.5 million to help small shops and businesses reopen.

Both responses — America’s to a tragedy half a world away, Pittsburgh’s to a crisis right here at home — illustrate a core American belief in the importance of private philanthropy and the value of nonprofit organizations. As a people, we believe government cannot do it all and that sometimes the best and most effective way to deliver help is through independent organizations whose reliance on charitable resources allows them to be more efficient than government and more socially minded than for-profit companies.

There is elegance in this system — and wisdom. There are floods in America every single day — not necessarily the type you see on the evening news, but no less devastating: rising tides of hunger, poverty, joblessness and sickness; tides that can ruin lives, threaten families and overwhelm communities. The nation’s rich supply of nonprofits helps us keep those floods in check and replace hopelessness with opportunity, ignorance with education, and pessimism with inspiration.

The moral of this tale is that a community rich in nonprofit resources is a community rich in hope and opportunity. Fortunately, Pittsburgh is one such community. At a time when our city is struggling financially and some in government are calling on nonprofits “to do more” to help, it might be useful to remember the special role nonprofits play in our community every day.



## WHY NONPROFITS MATTER

NONPROFITS OCCUPY A UNIQUE POSITION in our society. They exist to serve the public good and improve the quality of our lives. Their work usually falls into one of three categories, exemplified by: **hospitals, counseling centers, homeless shelters, food pantries and mentoring programs** that provide services directly to those in need; the **advocacy and social-action organizations** that draw attention to societal issues and advocate for change; and the **universities, religious institutions, theatres, zoos and libraries** that enrich our minds and enhance community life and culture.

While they share many common characteristics, nonprofits embrace a broad spectrum of belief systems, ideologies, structures and services. Some are motivated by religious faith; others, by a passion for a specific cause, such as the arts or human rights. Whatever they may base themselves on, all nonprofits are barred from engaging in partisan political activity.

Until about five decades ago, nonprofits — known then simply as charities — were American society's only real mechanism for responding to social and economic distress. As social ills grew more complex, however, the costs of addressing them skyrocketed. Nonprofit resources could not keep pace, so society increasingly turned to government. While nonprofits did not disappear, they were no longer in the driver's seat.

Today, that trend may be reversing, as limited government resources coupled with growing citizen activism unleash a new surge of nonprofit activity. In an era of government downsizing, society seems once again to be shifting its reliance to nonprofits as critical service providers and drivers of social change.

During the past fifty years, here as elsewhere, the nonprofit sector has quietly come of age and become a major force. In Allegheny County alone, there are now nearly 1800 nonprofits with more than \$10 billion in revenue, \$20 billion in assets and a \$3 billion payroll.

This means that nonprofits are critical not only to the social fabric of our community but also to its economy. Just imagine what would happen if that payroll suddenly dried up, or if government suddenly had to pick up the tab for services now provided by nonprofits. Or imagine what would have happened to Pittsburgh after the collapse of the steel industry without the region's foundations and nonprofits stepping in to retrain workers, develop new industries, invest in schools, revitalize business districts and maintain cultural organizations.

But these statistics about the sector's size could be misleading. Half of the region's nonprofit assets are concentrated in health care — mostly hospitals providing critical care and jobs. The sector as a whole is surprisingly fragile. Close to 90 percent of nonprofits in the region have operating budgets of less than \$1 million each and capture only 10 percent of the sector's total revenue. In fact, two of every five Allegheny County nonprofits operated at a deficit in 2001. This does not mean that

they are poorly managed. But most operate on extremely tight budgets, and all are struggling to adjust to changing times just as governments and businesses are.

As Peter Drucker pointed out in 1993, “Every few hundred years in Western history there occurs a sharp transformation. Within a few short decades, society rearranges itself — its worldview; its basic values; its social and political structure; its arts; its key institutions. Fifty years later, there is a new world.” We seem to be at the edge of such a transition in the relationship between nonprofits and government. Regions such as ours cannot afford for that transition to be handled badly. For us, the stakes are high.

Crafting this redefined partnership will be tricky. On the one hand, there is an unprecedented demand for nonprofit services and growing recognition by government that nonprofits are economical and efficient systems to meet those demands. On the other hand, government is in a state of flux, and fiscal concerns are forcing governments to reassess their priorities, budget allocations and the expectations they have of nonprofits. The assets and revenues of those nonprofits that are lucky enough to have them are tempting targets for cash-starved municipalities and other units of government.

Nonprofits, like every other sector in our society, clearly have a stake in helping government to remain solvent. But as we consider how to forge a new partnership between government and nonprofits here in the Pittsburgh area, we would do well to remember that the ultimate value of nonprofits in our community lies in the services they provide and the functions they perform.

For nonprofits, money redirected to pay for government would not mean less profit for shareholders, as it would in the case of a for-profit company. Nor would it represent a cost that could just be passed along to customers. Instead, it would mean one less meal at a food kitchen, one less mentor for a child, one less furnace for a flood victim in Millvale.

THAT BLUNT CALCULUS HELPS TO EXPLAIN why, like charitable entities throughout the United States, “purely public charities” are exempt from property and sales tax in Pennsylvania. This exemption has its roots in the Pennsylvania constitution, common law and statute.

WHY  
NONPROFITS  
ARE  
TAX-EXEMPT

While the law has not always been clear, today the requirements for a purely public charity are codified in a 1997 law colloquially known as “Act 55.” (The actual name is the Institutions of Purely Public Charity Act, 10 P.C.S.A. §§ 371 *et seq.*) The requirements for a purely public charity are stringent, and not all nonprofit organizations qualify for tax-exemption. Those that do qualify must be structured to ensure that they provide significant benefits to the public and relieve the government of some of its financial burden. It is this contribution to the public good that justifies the continued exemption of these organizations.

Under Act 55 and the common law, nonprofit organizations must satisfy five criteria to be classified as purely public charities and therefore exempt from taxation. The Act presents them in the following order:

First, a nonprofit organization must further a charitable purpose as defined in the common law. In other words, the organization must promote education or health, relieve the poor and disadvantaged, promote the arts, or undertake a fundamentally governmental service. These are purposes deemed to benefit the public in ways that regular commerce does not.

Second, a nonprofit organization will qualify as a purely public charity only if it operates entirely free from a private profit motive. Purely public charities may not compensate employees based on the financial success of the organization, in contrast to for-profit entities that can provide stock options to employees. Any increase in the value of the organization because of the creativity of the employees must be dedicated to the organization's mission and must be used solely to provide additional services to the people assisted by the charitable entity. Upon dissolution, all of the organization's assets must be transferred to another purely public charity, and no individuals may benefit from the distribution of assets. The purpose behind this requirement is to ensure that income and assets of the charity are available only to further the charitable purpose of the entity.

Third, a purely public charity must give away a substantial portion of its services. Most charities easily satisfy this requirement because the fees they receive, if any, are far below their costs of operations. Homeless shelters, food banks and organizations that assist abused or neglected populations are prime examples of this, as are libraries and museums. Even organizations that receive substantial fees qualify. Colleges meet the test because tuition for students is only a small fraction of the actual costs of educating them. Nonprofit hospitals qualify by subsidizing at least five percent of their costs, usually by providing an emergency room open to anyone regardless of ability to pay and by providing charity care to the uninsured. Arts organizations qualify because ticket prices are a fraction of operating costs. In other words, purely public charities must provide services at a loss to maintain their tax-exempt status and therefore must find additional funding sources, typically charitable contributions from the public or income from previous charitable contributions.

Fourth, purely public charities must benefit a "substantial and indefinite" class of persons who are legitimate subjects of charity. This simply means that the people assisted by the organization must be unable to provide themselves with the services being offered. It also means that these individuals cannot be predetermined; they must be selected in an objective and nondiscriminatory manner. This ensures that the public at large benefits from the nonprofit's operations. An organization created to assist particular individuals, such as family members of the donor, would not qualify as a purely public charity because the public benefit would be minimal.

Fifth and finally, a purely public charity must relieve the government of a burden. It must provide a service to the public that the government has historically funded or

might otherwise be obligated to provide. For example, human services organizations provide services to disadvantaged people — such as the mentally ill, the mentally disadvantaged, the homeless, the poor and the disabled — that would otherwise be provided by the government and paid for by taxpayers. The same holds true for organizations providing education, health care and a range of other public services.

As these five requirements make clear, the benefits provided to the public by nonprofits justify their tax exemption. The government is relieved of providing the services and thus of their costs, which lowers the tax burden on the public. Recipients of the services pay less than fair market value because the charities provide them below cost, which also benefits the public financially. Because of the prohibition on private gain, individuals associated with nonprofits cannot benefit at the expense of the public. And because services cannot be limited to a pre-determined group, the benefits of nonprofits are widely shared.

Any suggestion that tax-exempt organizations in Pennsylvania are somehow getting a free ride because they are not paying taxes completely disregards the basis for the tax-exemption and the significant financial burden already borne on behalf of the public by these organizations. The tax exemption is intended to provide some compensation for the public services provided by these organizations, whose very existence, in addition to enhancing our community, already relieves government of a significant cost.

**WHY  
NONPROFITS  
ARE  
EFFICIENT**

OF COURSE, THAT STATEMENT HOLDS TRUE only as long as nonprofit organizations provide services competently and efficiently. Where nonprofits fail in that regard, the public is generally quick to insist that government step in and either provide the services itself or at least demand better of nonprofit providers. Fortunately, Pittsburgh's nonprofit leaders rank high as diligent stewards of the public resources under their control.

Public charities, despite their nonprofit status, operate in a fiercely competitive environment. To be successful, they must earn the public's trust and its voluntary contributions — again and again. Acutely aware of this accountability, leaders of nonprofits repeatedly call upon their own creativity and innovation so that their organizations can help as many people as possible — while keeping costs low and quality high.

Because the nonprofit sector has matured, more and more of its leaders are trained well and qualified to serve admirably. Research commissioned by The Forbes Funds has found that, in our region, 70 percent of local nonprofit directors hold graduate degrees, a remarkable figure given that less than one-quarter of all local adults have earned college degrees. Perhaps more remarkably, these directors have foregone opportunities to earn higher salaries in the for-profit sector or reliable pensions in government.

A common theme for these leaders is helping their organizations “to do more and to do it better.” According to Forbes Funds’ research, 70 percent of local nonprofit organizations operate according to current strategic plans. In the past two years, approximately two-thirds of nonprofits have sought outside assistance for board training, program evaluation and information technology. During the same period, 60 percent of nonprofit leaders have attended training seminars, and 55 percent have participated in peer learning activities.

These directors know that they must invest in helping their organizations to deliver high-quality services and, because donors increasingly demand it, to measure their results. More and more, leaders of nonprofits are restructuring their organizations to be as efficient and results-oriented as for-profit businesses — although their critics would balk if they ever actually paid their staffs high salaries, invested in far-reaching professional development or adopted large marketing budgets like businesses routinely do.

In our region, nonprofits are actively working to reduce administrative costs, eliminate duplicative services and collaborate with peer agencies. More than 80 percent of local nonprofits cooperate with other nonprofits for the purposes of identifying community needs and serving clients. Nearly two-thirds partner with government agencies. Mergers, restructuring and creative partnerships are becoming more common. For example, three organizations — Bethlehem Haven Women’s Shelter, the Center for Victims of Violent Crime and the Pennsylvania Organization for Women in Early Recovery — recently arranged to hire one human resource professional to serve all three agencies. And two other organizations, Wesley Institute and Youth Places, are collaborating with a third, the Community Quality Institute, to implement customer service and quality assurance practices.

What’s more, many nonprofits have cut the fat from their budgets, if any fat ever existed. Most regional nonprofits operate with less than a three percent cushion in their budgets. On average, they use more than four of every five dollars to directly support program expenses.

The mounting pressure on nonprofits to raise funds and reduce expenses while still maintaining quality and expanding services is leading to a growing reliance on user fees. This trend is troubling because it may erode nonprofits’ ability to serve the poor and vulnerable, who need their services most. Already, for example, three of every four dollars supporting preschool and child care are paid by clients. Among human service nonprofits, client fees account for 40 percent of revenue, while government contracts account for only 28 percent, and donations from foundations, corporations and individuals for only 21 percent.

A more positive trend is a growing reliance on *earned* revenues. For example, Pittsburgh’s Good Grief Center now sells bereavement care packages, a positive source of revenue for the organization and a thoughtful gift for someone struck with the loss of a friend or loved one. Another organization, Life’s Work, now trains some of its clients at a Ben & Jerry’s ice cream shop, a joint venture with a for-profit



partner. The Bidwell Training Center sells orchids cultivated by urban youth to local grocery stores.

Realistically, there is a limit to how much revenue these activities can generate, and an overemphasis on them can divert nonprofits from their core mission. Nonetheless, local nonprofit leaders are taking on such risks as they push their organizations toward greater self-sufficiency. They are working hard to diversify their revenue mixes because they know they have to do so if they aim to keep their doors open to the community.

In a time marked by economic downturn, budget shortfalls and changing policy priorities, more of us are turning to nonprofits to address our communities' needs. It is appropriate that we do so because these organizations and their leaders are working harder than ever before to earn our trust and, with it, our support. The evidence suggests they are succeeding. In our region, 89 percent of local residents rate nonprofits highly in helping people, and 85 percent believe that nonprofits deliver programs and services well.

To be sure, leaders of nonprofits and their organizations can always find ways to improve. There is no such thing as a perfect organization, in either the for-profit or the nonprofit world. Still, the great news is that, in our region, many of our nonprofit leaders are doing precisely those things that build the strong organizations our community needs to take on tough problems like domestic violence, hunger, poverty and, yes, flood relief.

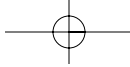
DESPITE THE MANY WAYS in which the nonprofit sector already contributes to the well being of our region, leading nonprofits in our community have agreed to divert precious resources away from their core activities to help alleviate the City of Pittsburgh's budget crisis. Together they have formed the Pittsburgh Public Service Fund, a consortium of nonprofits that have pledged several million dollars to the city's fiscal relief effort.

A  
FRIEND  
INDEED

This was not an easy decision. Already operating on tight budgets, already strained by the demands for their services, and already relieving government and taxpayers of costly burdens in countless ways, many nonprofits are hard pressed to find the resources to come to the rescue of city government.

This, however, is what nonprofits do. They step in when crisis strikes to help those who are suffering or in need. Nonprofits live by the credo embodied in the old proverb, "A friend in need is a friend indeed." Pittsburgh is our home, our friend. It is in trouble, and it needs our help.

Pittsburgh's nonprofit sector believes it would be profoundly wrong for city government to make balancing its books on the backs of nonprofits a permanent feature of its fiscal profile. That must never happen. But the nonprofit community is willing to help its hometown in a special moment of crisis and great need.



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