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Charting The Course:
Legal Help For Nonprofits In Troubled Times

Introduction

As the recession spread worldwide in the fall of 2008, many nonprofit organizations in New York and across the country faced major operating stresses that jeopardized their programs and disrupted their plans. For some nonprofit organizations, a strong commitment to serving clients' needs and hope for a quick economic turnaround meant putting off, longer than financially prudent, difficult decisions about how to control costs, raise additional funds, and preserve essential programs. For others, modest reserves and the sudden severity of the economic downturn required them to confront resource and operational challenges more immediately. As the impact of the economic downturn on the nonprofit sector deepened in the second half of 2009 and 2010, more nonprofit organizations changed their budgets, structures, and activities in an effort to cope with a new economic reality. Throughout 2011 and 2012, amidst the threat of further reductions in state and local government support, the nonprofit sector continued to make adjustments and strive for stability. From the organizations particularly susceptible at the start of the recession to those better prepared for the stress, most nonprofit organizations – especially those serving low-income populations and neighborhoods – must now operate with a revised set of assumptions, procedures, and partners in order to preserve programs and move forward. This paper discusses how legal assistance can help.

At stake is a sizeable and vital segment of the United States economy. The nation's 1.6 million nonprofit organizations employed approximately 10% of the total United States workforce or 13.5 million persons in 2009. The nonprofit sector provides 5.5% of the nation's Gross Domestic Product, constituting more than $750 billion worth of output.[1] Equally impressive is the wide range of program offerings that benefit the broad public interest, but are not similarly provided by the government or private sector, including those that further human services, health services, education, arts, environment, civic rights, economic development and more. Moreover, many charitable organizations form critical support and relief networks that benefit children, senior citizens, minorities, and other underserved

[1] *The Sector's Economic Impact*, Independent Sector, citing National Center for Charitable Statistics figure for 2009 released in Mar. 2011, http://www.independentsector.org/economic_role.

populations in their communities. Thus, the negative impact of the recession on nonprofit organizations strains not only their own viability and the job security of their employees but also the intended beneficiaries of their programs and services.

The nonprofit sector has plenty of experience working tirelessly with limited budgets, increasingly doing more with less, but this prolonged recession has challenged even the most resourceful organizations. Decreased cash flow, exacerbated by an increased demand for services, traps nonprofits in a constant, rather than cyclical, state of financial strain. To sustain programs in the changing economic environment, adaptable nonprofit organizations have reexamined one or more of the following five qualities critical to their success: mission, people, facilities, funds, and relationships. In each of these five areas, they have had to navigate a range of legal issues related to their structure and operations. For example, an organization's corporate purposes can empower but also limit the scope of activities. To the extent organizations decrease labor costs by reducing staff, staff salaries or benefits, employment law considerations will apply. Renegotiating or exiting leases to reduce occupancy costs raises real estate law questions. Financial transactions, such as borrowing money, trigger corporate law principles. Tapping into cash reserves or expanding fundraising efforts may implicate laws concerning restricted gifts or charitable solicitation. Efforts to increase operational efficiencies, such as forming partnerships with other providers, may raise contract, intellectual property or regulatory issues.

This paper seeks to analyze the impact of the economic downturn and a protracted weak economy on nonprofit organizations in the context of the legal and regulatory framework in which they operate. By law and practice, nonprofit organizations are different from for-profit businesses in several fundamental respects that can affect their options during tough financial times. Nonprofit organizations are mission-driven entities. They do not have private owners or shareholders; they can raise charitable funds, but not private equity. Finally, nonprofit organizations are governed by a board of directors that is charged with preserving organizational assets and furthering the organization's charitable mission. When nonprofit organizations make changes to their mission, people, facilities, funding or relationships, the effectiveness of the directors' decisions and manner in which the changes are implemented are important factors in the ultimate success of any organization's strategic choices. Because nonprofit organizations are so significant to American society, and demand for their services is so high, the legal sector should work closely with the nonprofit sector to help such organizations make legal changes and pursue public policy developments that preserve vital programs.

The severity and timing of the recession and its impact on the nonprofit sector varies in different parts of the country. This paper addresses the economic and legal issues affecting nonprofit organizations nationwide, while focusing on data and examples from New York City's nonprofit sector. It gives special attention to issues faced by the human services, economic development and community based organizations that seek to alleviate hunger and homelessness, stimulate access to jobs and capital, and serve children and youth, the elderly, and other poor or disadvantaged individuals and families. We emphasize the experiences of these organizations for two reasons. First, these organizations often have roots in the neighborhoods where their low-income constituents live, making their safety net services particularly vital when an economic crisis leaves millions of Americans unemployed and underemployed. Second, many of these organizations rely heavily on state and local government funding, so state and local government budget cuts greatly endanger their programs.

Part I of this paper provides factual background by summarizing the financial challenges nonprofit organizations and low-income communities face because of changes in foundation giving, cuts in government funding, and pressure on individual donations. It also recognizes the simultaneous strong demand for services. Parts II through VII examine many of the common legal issues associated with the coping strategies that nonprofit organizations have used, and may continue to use, to sustain their five pillars: mission, people, facilities, funding, and relationships. Part VIII reflects on the implications of a long term economic downturn and posits practical and policy recommendations to help foster stability and momentum for nonprofit organizations. This includes promoting legislative advocacy by nonprofit organizations rationalizing government contracting, simplifying regulatory reviews, and expanding access to working capital to enable these organizations to endure disruptions in government funding more effectively.

While the financial outlook remains unpredictable, there are legal strategies that nonprofit organizations can pursue going forward to minimize risks, preserve programs, maximize their resources, and better position themselves to carry forth their programs. As the leading provider of business and transactional legal services to nonprofit organizations that are improving the quality of life in New York City neighborhoods, Lawyers Alliance for New York has made it a priority since late 2008 to help the nonprofit sector cope with the legal impact of this economic downturn. Appropriate legal guidance can help organizations persevere notwithstanding tough financial times. We welcome the opportunity to share our knowledge of the legal and public policy framework with a wider audience and help more resource-constrained nonprofit organizations adjust to a challenging and uncertain economic reality.