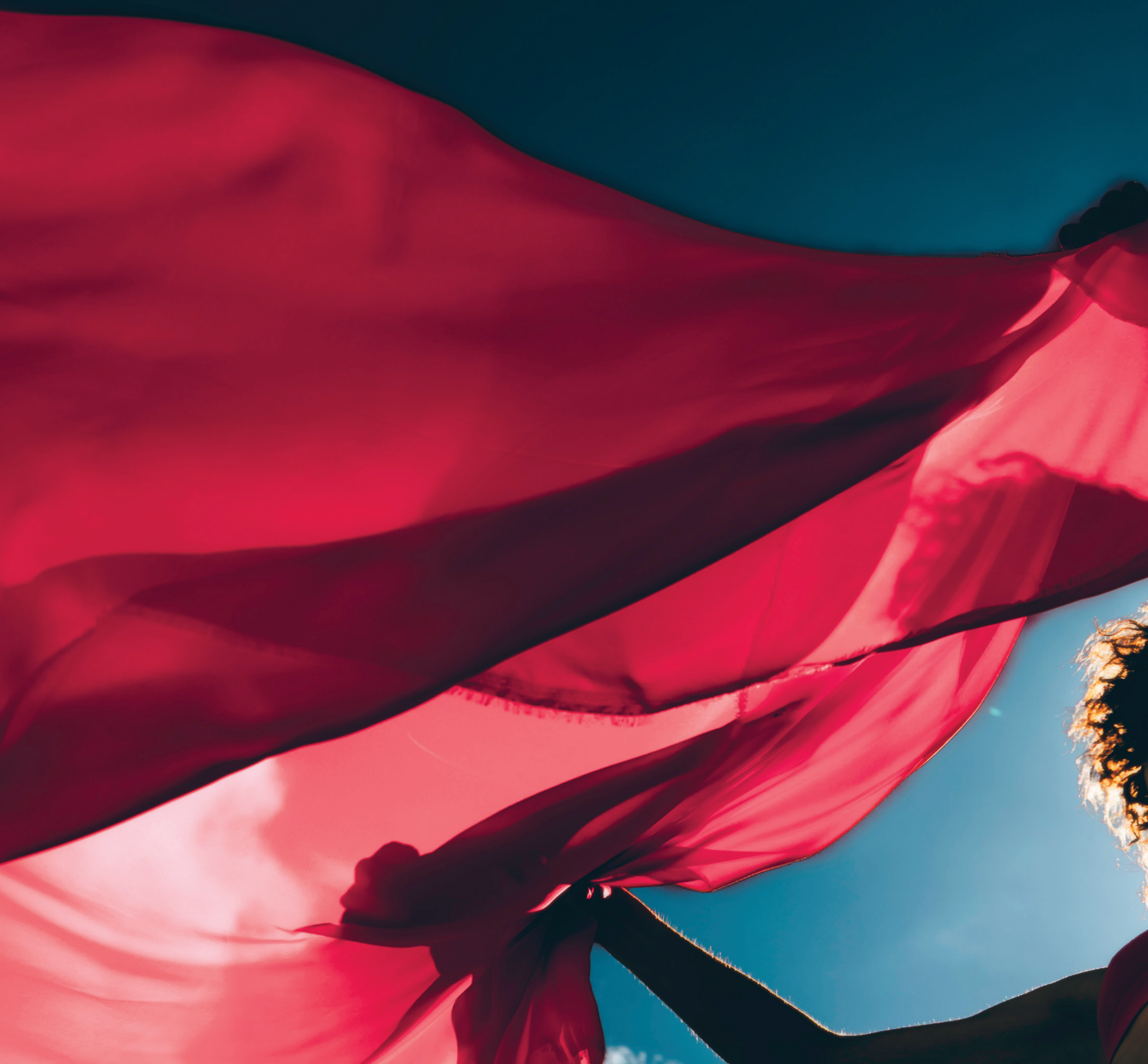
Vanguard

# Focus on the future

## The outlook for nonprofits



It's a new world out there for nonprofits. Most nonprofits survived the COVID-19 pandemic through a combination of government support, relaxed donor restrictions, monetary support from both board members and external donors, and suspension of many programmatic activities. Now that we've shifted to endemic status, temporary supports are winding down and costs are rising—translating to a softer outlook for fundraising. Today, nonprofits are urgently adjusting their business models in real time.

The overall U.S. economy is adjusting to an environment marked by increased costs, higher interest rates, reduced access to borrowing, and worker shortages. The same is true for nonprofit organizations, even as you face additional challenges unique to your sector. Fundraising is down; it's harder to recruit volunteers at every level, from board to frontline programming; and higher operating costs are shrinking surpluses or expanding deficits, even as demand for your services remains strong.

Even before the three-year pandemic public health emergency (and its special federal aid programs) ended in May 2023, nonprofits had already witnessed increased demand for food pantries and homeless services.[1] A survey of several hundred nonprofits conducted by findhelp in late 2022 found that "an overwhelming majority of nonprofits (95%) said demand for their services has increased in the past year. 61% of respondents said demand has increased 'substantially.'"[2]

With these challenges piling up, where do you go from here? Let's explore the current environment in greater depth, reflect on the successes that helped nonprofits like yours navigate the pandemic, and review the questions you should ask yourself to prepare for the post-pandemic landscape.

# Where are we today?

## The macroeconomic picture

Let's set the stage. Although we continue to experience COVID-19 cases, the health emergency is over. As a result, the extraordinary level of government support is behind us—for example, Coronavirus Aid, Relief, and Economic Security (CARES) Act funding has ended, along with supports such as extra Supplemental Nutrition Assistance Program (SNAP) benefits (formerly known as food stamps).

The economy is slowing despite low unemployment of 3.8% and a constrained labor market.[3] And though the average inflation rate is declining, it remains elevated.

### Nonprofit employment and recruitment

According to the George Mason University nonprofit employment data project, by the fourth quarter of 2022, the nonprofit sector had recovered the 1.65 million jobs lost during the pandemic.[4] Despite this seemingly positive news, most nonprofit observers still report continuing staffing vacancies, higher costs for both salaried and hourly positions, and a difficult environment for recruiting board members and volunteers. According to a recent U.S. Census Bureau and AmeriCorps survey, formal volunteer participation was 23%, dropping 7 percentage points from 2019 to 2021. That's the largest decrease the survey has recorded since it started in 2002.[5]

Likewise, 78% of the respondents surveyed for the 2023 Forvis *State of the Nonprofit Sector* report said they were trying to fill staff vacancies, and 50% are having difficulties delivering services due to staffing shortages.[6] As entry-level and minimum-wage pay has risen, nonprofits accustomed to paying $12-$15/hour now pay $16-$20 or more. What's more, skilled positions, particularly in finance and accounting, are proving even more difficult to fill due to high demand, increasing salaries, and the desire to work from home.

Senior staff at many organizations are wearing multiple hats: CFOs are adding controller responsibilities and executive directors are taking on fundraising duties. The result? Increasing concerns about burnout. In addition, as the proportion of 55+ workers continues to decline, many nonprofit heads are choosing early retirement or winding down their responsibilities, leaving their organizations to replace them—and the executives looking for ways to feel better about stepping down.

Looking forward, it's possible that if organizations consider offering part-time opportunities, say 20 hours a week, they might attract some of the recently retired 55+ cohort back into the workforce. In addition, layoffs in the tech sector may ease some of the difficulty nonprofits face in hiring skilled IT workers. Enhancing benefits and devoting time to improving work-life balance can also help both recruitment and morale.

## Pressure on business models

According to the Forvis, 93% of the respondents are spending more on employee salaries and benefits.[7] Wages have risen nationwide, reaching $20-$24/hour in some areas, impacting most nonprofit sectors, including hospitals (orderlies and cafeteria workers), food pantries (food pick-up and delivery, warehouse workers), and a broad array of social services charities.

In addition, costs for most categories, from office supplies to food to insurance, are on the rise. In the table below you'll note several categories that have seen large percentage increases (noted in bold).

| How have operational costs changed | Increased significantly | Increased somewhat | No change | Decreased somewhat | Decreased significantly |
|---|---|---|---|---|---|
| Salaries and benefits | **35.9%** | **57.1%** | 3.5% | 2.4% | 1.2% |
| Rent, lease, or mortgage | 0.6% | 23.2% | 70.1% | 3.7% | 2.4% |
| Repairs and maintenance | 7.9% | **41.8%** | 44.9% | 5.5% | 0.0% |
| Utilities | 11.0% | **45.4%** | 39.9% | 3.1% | 0.6% |
| Transportation and travel | 9.5% | **54.2%** | 24.4% | 11.9% | 0.0% |
| Office equipment and supplies | 5.3% | **47.3%** | 39.6% | 7.7% | 0.0% |
| Professional services | 10.2% | **58.1%** | 29.3% | 2.4% | 0.0% |
| Marketing and advertising | 5.5% | **51.5%** | 41.2% | 1.8% | 0.0% |
| Taxes and insurance | 7.1% | **57.1%** | 35.1% | 0.0% | 0.6% |
| Total average | 10.3% | 48.4% | 36.5% | 4.3% | 0.5% |

Source: *State of the Nonprofit Sector*, Forvis, 2023.

| Change in operating costs | 2022 | 2023 |
|---|---|---|
| Increased significantly | 6.5% | 10.3% |
| Increased somewhat | 23.1% | 48.4% |
| No change | 14.4% | 36.5% |
| Decreased somewhat | 44.0% | 4.3% |
| Decreased significantly | 12.0% | 0.5% |

Source: *State of the Nonprofit Sector*, Forvis, 2023.

# Four nonprofit sectors

Let’s look at the current environment for four of the largest specific nonprofit sectors:

- Health care
- Higher education
- Social services
- Arts, culture, and humanities

one

## Health care

Although the pandemic is over and numbers have fallen, daily COVID hospital admissions remain above 3,000 and health care providers continue to treat pandemic-related issues such as mental health challenges and the consequences of patients putting off routine doctor visits and tests.[8] In addition to the staffing issues previously mentioned (including the number of doctors and nurses retiring during the pandemic), this sector is experiencing a perfect storm as costs rise but reimbursements are flat to down.

two

## Higher education

Enrollments are declining, in part due to the pandemic and the struggling economy. But beginning in 2025, the traditional college-going population will drop by 15% over the subsequent five years, which observers are calling the demographic cliff.[9] And sticker shock is causing skepticism as students and their families worry about taking on significant debt to finance education and question the value of a college degree.

Net revenues are also under pressure. As gross tuition costs continue to rise, greater discounting and student aid are reducing net tuition income. Plus, endowment returns have dropped and other sources of support are harder to come by. Like other sectors, higher education is facing higher costs and staffing issues. Hourly workers are leaving, there's high turnover in administrative areas like admissions and development, and adjunct faculty are in some cases growing restless.

Finally, there's growing disparity between the "haves"—elite private schools and flagship state universities—and the "have nots," even as schools contend with an increasing sense of politicization, including concerns about free speech and how that might impact academic settings.[9]

three

## Social services

Demand for services is high and will continue to increase as the economy slows, even as costs are rising. In the 2023 Forvis report, 68% of the respondents have had increased demand for their programs and services. Likewise, findhelp, an organization that connects local communities with social care resources, surveyed over 300 nonprofits in Q4 2022 and found that more than 75% were concerned about their ability to meet demand for services, particularly for food, housing, and utility services.[10]

Amid these challenges, government contract rates, which form a significant portion of the revenues in this space, don't account for inflation and still don't cover full indirect costs.

four

## Arts, culture, and humanities

Attendance for museums and performing arts organizations has been slower to come back than expected and funding is down.  Organizations expended significant resources to reach audiences online, though the added costs may not have resulted in additional revenues. But the landscape is improving: According to Laura Lott, CEO of the American Alliance of Museums, museum attendance is at 70% of pre-pandemic levels, and she believes it will take another year or two for a full return.

The George Mason University nonprofit employment data report indicates that as of December 2022, employment was still at 88% of pre-pandemic levels, a trend confirmed by Independent Sector's latest quarterly report on the health of the nonprofit sector.[11] Organizations appear reluctant to return to pre-pandemic staffing levels until the number of audiences and visitors is closer to what it was prior to 2020.

# Fundraising and support

Long-term trends continue to concern observers: Although total dollars given has risen, there are fewer donors, and those donors are wealthier. Giving USA data shows consistent growth in giving except during recessions (there were declines in 1990-91, 2000-02, and 2008-09).[12] However, even if the economy averts a recession later in 2023 or 2024, the weak performance of capital markets in 2022 doesn't bode well for fundraising. In fact, the Fundraising Effectiveness Project (FEP) reported that the number of donors fell by 10% in 2022 from year-earlier levels. Giving leveled off in Q3 2022 and weakened in the fourth quarter, which is typically the height of the giving season.[13]

On a similar note, two-thirds of respondents in the findhelp Q4 2022 survey of over 300 nonprofits said that fundraising has remained the same or has decreased even as demand for services has grown.[14]

According to Independent Sector's March 2023 quarterly report *Health of the U.S. Nonprofit Sector*, for the period ending September 2022 total dollars donated were up 4.7%, but the number of donors dropped by (7.1%) year/year and donor retention fell (3.1%). Retention was a particular problem for small donors (less than $100), where nonprofits only retained 21.5%. Even for donors giving over $50,000, retention was about 55%.[15]

Surveying 33 fundraising consultants with hundreds of nonprofit clients, the *2022-2023 ADRFCO Survey: Compiling Insights into the Nonprofit Sector* found two-thirds of respondents saying nonprofit clients met or exceeded fundraising projections for 2022, but almost 69% said results fell short of 2021's outcomes and 44% said clients have lowered their expectations further for 2023.[16]

Donors are increasingly offering nonprofits potentially valuable but illiquid gifts, such as land and pre-initial public offering stock. But it's important to keep in mind your organization's gift acceptance policies and to exercise caution before receiving gifts that could prove difficult to sell.

While state and local government finances appear to be in good shape, nonprofits continue to be concerned about the pullback of pandemic-era support, along with the reality that demand for services is outpacing government programs.

Yet, there's reason to be hopeful. The pandemic saw funders loosen restrictions on grants and put some pressure on governments to cover more indirect costs in their nonprofit contracts. There's also a more general move to get funders to recognize that overhead is a necessary part of any business and to reimburse more overhead costs. However, the BDO survey of health and human services organizations shows that recovery of indirect costs remains a priority.[17]

## Some Federal support still available

The CARES Act permitted nonitemizers a $300 charitable deduction and an unlimited deduction for gifts of cash to public charities. This expired in 2021, taking away a powerful incentive for potential donors. But, the Tax Cuts and Jobs Act (TCJA) is still in force until 2025. This increased the charitable deduction for cash contributions to public charities from 50% to 60%.

# Nonprofit financial health

Nonprofit financial health was robust at the beginning of 2022, as measured by the Nonprofit Finance Fund's 2022 *State of the Nonprofit Sector Survey*, which interviewed over 1,100 nonprofits from around the United States.[18] This is mostly a result of governments and donors stepping up support during the pandemic. But, as we've seen, conditions are likely to become more challenging in the post-pandemic environment.

Several factors helped nonprofit financial health, including:

- Low interest, forgivable Paycheck Protection Program (PPP) loans.
- Meaningful changes in funding from foundations (51% of nonprofits reported receiving foundation funding in 2021 versus 38% in 2017).
- A buildup of nonprofit reserves (see chart).
- An increase in the number of nonprofits with any reserves (60% in 2022 versus 49% in 2018).
- More nonprofits reporting four or more months of cash on hand (47% in 2018 to 64% in 2022).
- More nonprofits achieving surpluses on their statement of operations (54% in 2017 to 66% in 2021; see chart).[19]

| Reserves as percentage of operating expenses | 2018 | 2022 |
|---|---|---|
| >50% | 7% | 14% |
| 25%-49% | 11% | 22% |
| 10%-24% | 32% | 29% |
| <10% | 49% | 32% |

Source: Stanford Social Innovation Review, 2023.

| Surplus status | 2017 | 2021 |
|---|---|---|
| Surplus | 54% | 66% |
| Break-even | 23% | 18% |
| Deficit | 23% | 16% |

Source: Stanford Social Innovation Review, 2023.

The Forvis report echoed the Nonprofit Finance Fund findings (with a smaller number of respondents). In general, 55%-56% of nonprofits said their financial position was either unchanged or had increased.[20]

| Financial position | Large | Midlevel | Small |
|---|---|---|---|
| Increased significantly | 14.1% | 6.3% | 0.0% |
| Increased somewhat | 21.9% | 40.0% | 34.5% |
| No change | 20.3% | 13.8% | 20.7% |
| Decreased somewhat | 35.9% | 38.8% | 44.8% |
| Decreased significantly | 7.8% | 1.3% | 0.0% |

Source: *State of the Nonprofit Sector*, Forvis, 2023.

Forvis also found that organizations with over one month of reserves generally increased reserves, except for those with seven to twelve months, which drew down reserves.

| | 2022 | 2023 |
|---|---|---|
| < 1 month | 2.5% | 2.4% |
| 1 month | 6.5% | 5.9% |
| 2-3 months | 12.9% | 15.9% |
| 4-6 months | 14.5% | 22.9% |
| 7-12 months | 39.4% | 21.2% |
| >12 months | 24.3% | 31.8% |

Source: *State of the Nonprofit Sector*, Forvis, 2023.

## Going forward

Citing the Nonprofit Finance Fund report, a January 2023 piece in the *Stanford Social Innovation Review* offers the following observations: "*…demand continues to rise for nonprofit services. Among the respondents, 85 percent anticipated increased demand in the next year, with 43 percent predicting a large increase (10 percent or more) in demand—about a third more than in 2018. Employing enough staff to do the work and offering competitive pay were the most cited staff management challenges.*

*The good news is that more nonprofits feel prepared to meet rising demand in the coming year (56 percent) than they did in 2018 (42 percent). And they're hiring for it: 67 percent of the nonprofits surveyed said they planned to increase staff in the next 12 months.*"[21]

## Reshaping the nonprofit sector

While it remains to be seen how many of the pandemic-era changes will become permanent, it's fair to note that there were two broad shifts that could continue to influence nonprofits: Trust the grantee and make the process easier for them. During the pandemic, donors in general, and foundations in particular, proved willing to provide general operating support and unrestricted funding.[21] These efforts received a big boost from Mackenzie Scott's "trust-based" philanthropy. Her grants are characterized as "no strings attached" and she has advocated giving to nonprofits with "lived experience in the regions they support and the issues they seek to address."[22]

In terms of making things easier for the grantee, there's been a relaxation of often-onerous reporting requirements imposed by both donors and government funders. And increasingly, observers are speculating about common grant applications.[23]

## Supporting social sector infrastructure

The Urban Institute has issued several reports calling attention to the importance of the social sector infrastructure in the U.S. and the desirability of broadening support, including funding, to organizations ranging from traditional (mutual aid societies and neighborhood associations) to new (giving circles).[24]

# What happens next?

The good news: Most nonprofits made it through the pandemic. Now comes the task of preparing for the future. Here are some questions you and your board should consider.

**What pandemic-era changes are likely to remain with us in the post-pandemic era?**

Your organization will likely continue to be impacted by technology, such as greater use of virtual meeting platforms and services offered online; new fundraising tactics; different benefit offerings; and the use of hybrid staffing models.

**What pandemic-era challenges do we continue to face?**

The "great exhaustion" is still a factor. Consider this observation from *Philanthropy News Digest*, "People in the social sector are exhausted, suffer from low morale, and are overworked, and this has only gotten worse since the COVID-19 pandemic began."[25] According to the Urban Institute, burnout from an array of factors including overwhelming demand for services, insufficient staffing, and inadequate compensation is causing nonprofit workers to leave the sector...resulting in staffing shortages and service cuts.

**Business models**

- Does our model still work? Are we facing permanently higher personnel costs? What can we do about them? Can we diversify our revenue sources?
- Are there steps we can take to make our organizations even stronger? Are there efforts we should outsource? Insource? What is our core level of support from which to rebuild? Are all our programs equally successful?
- Should we permanently change to a remote or hybrid work schedule? Might this permit us to reduce our real estate costs and shrink our footprint while not scaling back services?
- Should we consider combining with another nonprofit? If we're in bad shape, can another organization continue our mission? If we're in good shape, can we (or should we) merge or take over programmatic efforts from a nonprofit that is struggling?

### Management

Now is a good time to consider your leadership. Do you have the right people, who are flexible, empathetic, and able to solve any challenges we're facing? Are they burned out? Likewise, think about your staff. Are you and your management team doing all you can to support both your staff and the clients you serve?

### Financials

- Do we need to rethink our financial outlook? Have we factored in rising costs, including wages and benefits? How reliable are our revenue forecasts?
- Do we need to rethink our reserve policies? Is our level of reserves adequate? Are reserves sufficiently liquid? Can we benefit from a committed line of credit?
- Do we need to strengthen our balance sheet? If yes, do we do it by reducing our programmatic footprint, raising more money, or a combination of both?

### Governance

- How well did our governance hold up during the pandemic? Did all board members step up to the plate? Did we enlist them to assist in our communications?
- Have we updated our governance documents? Does our language provide for virtual board meetings and decision-making? Can we call more frequent meetings? Have we reviewed signing and decision-making authorities?
- Do we have the right board members with the appropriate skills?
- Are we satisfied with our risk management capabilities?

### Technology and cybersecurity

Are we devoting enough money and attention to our computing infrastructure? Have we performed a cybersecurity review (or asked our IT consultant or auditor about such a review)?

### Strategic direction

- Have we convened a committee of the board to plan our future?
- Has our mission changed?
- What is our purpose?
- Has our ability to achieve our mission changed? What must we do to enhance our ability?
- How do we envision our place in the world? Have we thought about the attributes we have and those we wish to have?
- What are our priorities?
- Are our programs focused on achieving our priorities?

# References


1 "Pandemic Relief Is Ending, and What It Means to Nonprofits and Foundations," National Council of Nonprofits, April 13, 2023.

2 "Meeting the Moment: Community Organizations Nationwide See Challenging Times Ahead," Findhelp, November 29, 2022.

3 U.S. Department of Labor data, as of August 2023.

4 "First GMU-NED Report: Nonprofits Estimated to Have Recovered COVID Pandemic-Related Job Losses," George Mason University Center on Nonprofits, Philanthropy, and Social Enterprise, January 11, 2023.

5 "Nonprofits Scramble for Help Amid Dearth of Volunteers," The Chronicle of Philanthropy, April 20, 2023.

6 State of the Nonprofit Sector. Forvis, 2023.

7 State of the Nonprofit Sector. Forvis, 2023.

8 "COVID-19 Forecasts: Hospitalizations," CDC, as of October 2023.

9 "Looming Enrollment Cliff Poses Serious Threat to Colleges," BestColleges, January 27, 2023.

10 Status of the Nonprofit Sector. Forvis, 2023.

11 "Uncertain Economy—and the Nation's Debt Debate—Snag Nonprofit Finances," The Chronicle of Philanthropy, May 31, 2023.

12 Giving USA 2023. Giving USA Foundation, 2023.

13 "Fundraising Showed Concerning Weakness During 2022," The Nonprofit Times, April 17, 2023.

14 "Meeting the Moment: Community Organizations Nationwide See Challenging Times Ahead," Findhelp, November 29, 2022.

15 "Health of the U.S. Nonprofit Sector," Independent Sector, July 10, 2023.

16 "2022-2023 ADRFCO Survey: Compiling Insights into the Nonprofit Sector," The Nonprofit Alliance, 2023.

17 "Nonprofit Benchmarking Survey: Health and Human Services," Insights BDO, 2023.

18 "2022 State of the Nonprofit Sector Survey," Nonprofit Finance Fund, June 2023.

19 "Nonprofit Finances Now," Stanford Social Innovation Review, January 12, 2023.

20 Status of the Nonprofit Sector. Forvis, 2023.

21 "Nonprofits, Foundations Adjust to the Post-pandemic Era," Philanthropy News Digest, March 28, 2023.

22 "How Mackenzie Scott's $12 Billion in Gifts to Charity Reflect an Uncommon Trust in the Groups She Supports," Giving Compass, March 28, 2022.

23 Common Grant Application, 2023.

24 "How Social Sector's Growing Support System Can Best Help It Thrive," Urban Wire, February 27, 2023.

25 "Nonprofits, Foundations Adjust to the Post-pandemic Era," Philanthropy News Digest, March 28, 2023.