

# WORKING PAPER ON REVENUES:

*Delaware's Nonprofits Join the Movement to Explore State Budget Solutions*

## Budget Challenges for Delaware

There are several groups involved in Delaware's budgeting process. While the judicial branch is seldom involved, the legislative branch, via the General Assembly and its Joint Finance Committee (JFC), and the executive branch, via the Office of Management and Budget (OMB) and the Governor's Office, work together to produce the state budget. OMB holds public meetings in November each year to help state departments prepare their departmental budget requests. With these requests, OMB develops the governor's proposed budget and presents it to the General Assembly in January. The JFC is the bi-partisan, bi-cameral (consisting of members from both the House and the Senate) group of 12 state legislators responsible for building the budget in consultation with the General Assembly. The JFC holds public hearings in February and March for budget requests from state agencies and meets in late May and June to prepare the budget bills for introduction. Both the General Assembly and the Joint Finance Committee are supported by the Controller General's Office. The end product of this process is three budget bills, one that pertains to operating costs, another to capital projects, and the last is the Grant-In-Aid Bill, which will be discussed in further detail later in this report. The OMB then is responsible for executing the budget after it is passed.

Another group, the Delaware Economic and Financial Advisory Council (DEFAC) is a non-partisan government group that was created in 1977 to inform the General Assembly about Delaware's economic state, provide them with forecasted revenues and warn them of possible deficits (Delaware Business Roundtable [BRT], 2015, p. 2).

Delaware's budget challenges are not new. Due to economic factors beyond the state's control, including growing entitlement programming and population growth, in particular elderly population growth, it has been difficult to find adequate revenue to support expenditures (BRT, 2015, p. i). For the last several years, the state has relied on "silver bullets," or temporary budget solutions. These sources include abandoned property, gambling, the bank franchise tax, and casino revenues (Delaware Economic and Financial Advisory Council [DEFAC], 2015, p. 11). Initially, from, 2009-2014, abandoned property helped the state avoid an

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average of \$100 million per year in program reductions or tax increases (BRT, 2015, p. 6). Today, it provides for 16 percent of Delaware's revenue (DEFAC, 2015, p. 11). However, this source, along with other "silver bullets," is an unstable choice for long-term financial health and is expected to wane drastically. Delaware continues to rely on these temporary fixes as a way to avoid difficult choices regarding more conventional revenue streams (DEFAC, 2015, p. 11). While it is not likely that the state will abandon these sources, they will soon be forced to implement alternative solutions.

Ideal revenue sources are "elastic," or responsive, to both changes in the economy and population growth. Elastic revenue sources grow with the economy and in response to population increases. Despite economic expansion,

## Delaware Revenue Solutions Working Group

The Delaware Revenue Solutions Working Group (DRSWG) is a coalition of Delaware nonprofit stakeholders committed to informing nonprofit leaders, staff, board members, and volunteers of recent state budget challenges. The DRSWG was formed in July and has met with key groups including the Joint Finance Committee, the Office of Management and Budget, the Controller General, the General Assembly, the Delaware State Chamber of Commerce, the Business Roundtable, the Committee of 100 and more to discuss how Delaware's budget challenges affect the nonprofit sector. We recognize that nonprofit professionals are consumed with the responsibility of their own missions, which is why we have incorporated a synopsis of current events surrounding these issues, proposed solutions, and specific tailored information on how nonprofits are affected in one working paper. We will continue to inform you of updates, coordinate testimony of the sector at key OMB, JFC, and other meetings and advocate on behalf of Delaware's nonprofit organizations, as well as provide an Advocacy Toolkit and an Advocacy Calendar for your use throughout this very important fiscal year. We welcome your involvement in the group.

Delaware's revenues are not growing (BRT, 2015, p. 3). Income taxes (18% of state revenues), for example, should increase revenues when the population grows because more residents would result in more taxable income. However, because Delaware's population growth is mostly comprised of elderly citizens and Delaware has generous elderly tax preferences; revenues from income tax have not experienced the same growth. While revenues are not increasing, state government is burdened with the cost to provide services to a larger population. In addition to inelastic revenues, we have seen increasing expenditures, including those for education (BRT, 2015, p. 4-5). The combination of these two forces has resulted in a challenging budget problem for Delaware.

## Improving Budget Challenges

There are several approaches to solving Delaware's budget challenge. This section details the many proposed solutions provided by various stakeholders throughout the state. One approach involves initiatives to improve efficiencies within the budgeting process, while another includes initiatives specific to budget allocations.

### "Results First Initiative"

The Joint Finance Committee has initiated an effort to make the budget process more efficient. In June, the state signed an agreement with the Pew MacArthur Foundations' "Results First Initiative," an independent charitable foundation that analyzes government practices and suggests scientifically proven best practices and solutions based on their analysis. They currently work with 19 other states and will begin their work in Delaware with the Department of Corrections. Additionally, the state has contracted with a private consulting firm to recommend efficiencies in the Medicaid and Medicare systems. A preliminary report was released in June and the final report is due out in November 2015.

### DEFAC Revenue Council

Other solutions provide specific budget measures. The Delaware Economic and Financial Advisory Council (DEFAC) has proposed a handful of solutions. In May, DEFAC released a report called the "Final Report of the DEFAC Advisory Council on Revenues" as a result of Executive Order No. 47. The report explores several alternatives for increasing the elasticity of Delaware's revenue sources and still maintaining interstate economic competitiveness. While altering tax policy is never a popular measure, DEFAC finds this to be a reasonable decision because of Delaware's low tax burden. Delaware's state spending is sixth in the nation per capita, but its tax burden on citizens is the fifth lowest (DEFAC, 2015, p. 10), due to the

fact that the state has been able to export a large portion of its taxes to non-residents (DEFAC, 2015, p. 1). DEFAC does not necessarily favor raising tax rates, but suggests **broadening tax bases** of Delaware's primary revenue streams (income tax providing 18 percent of state revenues and corporate franchise tax and fees providing 25 percent of state revenues), and developing stable and diversified secondary sources (DEFAC, 2015, p.8). Specifically, DEFAC recommends removing itemized deductions from income tax calculations, as well as gradually increasing the age for elderly tax preferences. Taxing a larger portion of pension and retirement income will substantially increase revenues (DEFAC, 2015,

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p.51). DEFAC also suggests a statewide reassessment of property taxes so that this revenue source is responsive to growth in the economy. Currently Delaware ranks 44<sup>th</sup> for property taxes, providing 10 percent of state revenues compared to the national average of 22 percent (DEFAC, 2015, p. 9).

### Expenditure Committee

In recognition that revenues are only one side to the budget, the Governor's Expenditure Committee will assess ways to reduce expenditures. Their report is due out on January 29, 2016.

### Business Roundtable

The Business Roundtable (BRT), a group of Delaware business leaders, has led private sector discussions surrounding the improvement of expenditures. In August they released, "Delaware's Structural Budget Problem: Causes, Potential Solutions, and Policy Tradeoffs" a report by Michael C. Genest and Brad D. Williams of Capital Matrix Consulting. The report states that even if taxes are raised and revenues do increase, the budget shortfall will reemerge due to rapid growth in health-related costs (BRT, 2015, pp. 17-18). For this reason, they emphasize the importance of assessing and reducing state expenditures. Specifically, the report recommends slowing the growth of spending in the areas of K-12 education, Corrections, Public Welfare, and state employee personnel costs, as Delaware's spending in these areas is higher than national averages (BRT, 2015, p. 1). Additionally, the report calls for policies that contribute to

economic growth, as this will improve the state budget over the long term (BRT, 2015, p. 19).

## Public Nonprofit Funding in Delaware

With the movement of deinstitutionalizing and government downsizing in the 1980s, nonprofit contracts began to deliver services formerly provided by government institutions. Government officials recognized that not only could nonprofit organizations provide the full range of services more effectively than state agencies, but at a lower cost to the state overall. Since this shift, the partnership between nonprofit organizations and the government has been

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significant to Delaware's quality of life. Auger et al. describe nonprofits as, "formal 'street-level deliverers' of key state and local government services, via a system of contracts, grant and voucher arrangements" (2014, p.1). Often, the work of nonprofits helps to deliver and improve government programs.

## Fee-for-Service Contracts

In many instances, the state of Delaware contracts with nonprofits on a **fee-for-service** basis to fund the outsourcing of community services. With contracts, the government recognizes that it is less expensive and more effective to fund nonprofits than to pay state-run institutions to provide the same services. Instead of providing the service itself, the state agrees to fund the nonprofit organization to provide a particular service. Specific state departments will support nonprofits with missions relevant to that department's focus. In 2012, 235 nonprofits in Delaware reported receiving government funding or grants (Urban Institute, 2014, p. 117). Many health and human service agencies in Delaware have contracts with the state government.

## Grant-In-Aid

In addition to contracts, the state also provides smaller appropriations to nonprofits via the Grant-In-Aid bill. Appropriations are decided by the Joint Finance Committee upon the review of a formal application and are meant to serve as supplemental funding, as opposed to a nonprofit's main funding source (Office of the Controller General, 2015, para. 1). Of the \$45 million designated for the Grant-In-Aid bill, \$16 million goes to nonprofit charitable organizations (Delaware General Assembly, 2014, para. 5). The remainder

of funds supports senior centers, emergency responders, fire companies, and county seat packages (Delaware General Assembly, 2014, para. 5).

We appreciate the action taken by the JFC to make grant-in-aid increasingly efficient. In recognition of challenges to the review process, the JFC has voiced a desire to move towards decisions that are more outcomes-based. In 2014 and 2015, the Committee convened meetings with several key nonprofit groups including United Way of Delaware, Delaware Community Foundation, Delaware Grantmakers Association, the Delaware Alliance for Nonprofit Advancement, and the Pew MacArthur Foundation, to hear how these organizations evaluate their own grant applications. Some process improvements have been made in the past two years based on these meetings. More improvements are expected in 2016 as the application becomes electronic.

## Near Future for Grant-In-Aid

This year (fiscal year 2016), grant-in-aid funding was held at 2015 levels using a one-time settlement source that will not be available for fiscal year 2017. Without broadening and stabilizing revenue sources, it is likely that nonprofits will be affected by expenditure cuts through contracts and grant-in-aid. In previous years, in the face of budget challenges, the Joint Finance Committee has applied across the board cuts to organizations that receive funding, as opposed to prioritizing funding for organizations that are most efficient and effective, determined by an adopted evaluative component to the allocations process.

## Budget Impacts on Nonprofits

Nonprofit organizations are a vital component of Delaware's community and contribute greatly to quality of life in the First State. These organizations add public as well as financial value to Delaware through a "social contract" with the government. In partnership with the state, nonprofits create a social safety net, meeting crisis needs and supplying critical non-crisis services (Auger et al., 2014, p. 1). Nonprofits touch every citizen in their everyday life, often in unrecognized ways. The nonprofit sector consists of arts organizations, animal welfare groups, environmental organizations, private foundations, medical research, libraries, economic development and mental health services, as well as crisis support services such as soup kitchens and homeless shelters, just to name a few. The impact of these organizations is significant. Without nonprofit organizations such as these, the quality of life in Delaware would substantially suffer.

In addition to improving the quality of life in Delaware, nonprofits provide economic advantages. If it were considered as a separate industry, the nonprofit sector would rank as the third-largest industry in the state of Delaware, and it produces over \$130 million in employment-related taxes (Auger et al., 2014, p. 2). Nonprofits provide the state with a substantial amount of tax revenue and they save the government money. Nonprofits also attract national foundation and federal dollars to Delaware. Many nonprofits

***Each Delawarean with a disability that is employed by the help of a nonprofit saves the state \$2,307 per year in entitlement programming—a total of \$1.3 million each year (Matthew Greenwald & Associates, Inc., 2013, p. 1).***

engage in prevention work, which is less expensive and more effective than treatment work. Additionally, a Delaware resident with a disability, who is employed, often as a result of a nonprofit, saves the government \$2,307 per year in entitlement programming (Matthew Greenwald & Associates, Inc., 2013, p. 1). This statistic alone demonstrates a savings to the state of \$1.3 million each year.

The General Assembly may need to make cuts to nonprofits organizations for fiscal year 2017. While this seems like an expedient decision now, in the long run it will create higher expenditures and may lead to a decrease in services. Auger et al. explains, “Without nonprofits, state and local governments would have to provide services on their own, burdening the

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budget” (2014, p. 1). It is crucial for the General Assembly to remember the negative impact cuts to nonprofits will have on the financial stability of the state, as well as the overall quality of life in Delaware. Due to slow government payments, nonprofits are already financing government and services are being reduced. According to the Urban Institute, slow payment practices by government and other contracting factors have resulted a large number of Delaware nonprofits to operate in the “red,” 58 percent drawing on reserves and 17 percent increasing lines of credit (2013, p. 133).

#### **DRSWG Goals**

The nonprofit government partnership is a collaboration upon which we all rely. With the possibility of cuts in the future, DRSWG encourages nonprofits to reassess their funding now, and prepare a contingency plan for diversifying funding sources. DRSWG also recognizes the value of sustainability and fostering collaboration among nonprofits with similar missions in order to provide services to the community more efficiently.

With an understanding of the current events surrounding Delaware’s state budget, we hope you’ll be empowered to take steps to support nonprofits. We encourage you to build your “Advocacy Plan” now for 2016 and the Delaware Fiscal Year 2017 Budget. We hope to hear from nonprofits, large and small, about how government funding affects your organization, and the impacts budget cuts could have on the services you provide and the quality of life for Delawareans.

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