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Commentary/Op-Ed - June 2002

The Nonprofit Margin

New York City spends millions every year to help nonprofits provide needed social services in the five boroughs. So why doesn't the city let these linchpin organizations take advantage of tax incentives for relocation to alternative business districts the city promotes to for-profits?

by David Lebenstein and Arlene Wysong

With all the money the government pours into nonprofit organizations, it’s hard to believe policymakers would miss an opportunity to put those dollars to work.

Yet when it comes to one of the city’s major economic development priorities—-fostering alternative business districts in areas such as downtown Brooklyn, Long Island City and Harlem—-the city has long been asleep at the switch. Planners eager to encourage growth in these and other areas have fashioned a set of incentives that offer relocation benefits to everyone from Fortune 500 companies to failing dot-coms. These same incentives, however, exclude nonprofits-—which have both a proven track record and an aptitude for the assignment.

Nonprofits have two things that make them right for the job: pioneering spirits and tight budgets.

Just as struggling artists looking for large, inexpensive live/work spaces are often the first to colonize what later become desirable residential areas, nonprofits are frequently willing to be trailblazers, and their presence can help support a retail base and other amenities upon which a thriving neighborhood can be built. Simply making an area feel more vital makes it more attractive to companies that are looking at more than the bottom line when they decide where to locate-—a category that includes most for-profit businesses.

Which leads to the second attribute: Most for-profits share the mantra “location, location, location,” but in the nonprofit sector, it’s all about price. Nonprofits, in other words, will follow the money—which means that even relatively small incentives can have a tremendous effect on where these organizations choose to locate. And unlike other cost-sensitive companies—say, startups on shoestring budgets—when they arrive, nonprofits tend to be a stable and stabilizing force.

Take the case of Lower Manhattan. In 1995, when many of downtown’s old Class B buildings had already stood vacant for years, the city implemented the Lower Manhattan Revitalization Plan, which offered various incentives to landlords and tenants in an effort to give the area a boost. Among these incentives was a real estate tax abatement for buildings built before 1975, which was to be passed along to tenants through rent reductions and a cut in energy costs.

The plan succeeded, and one of the reasons it did is that it didn’t exclude any prospective tenants from taking advantage of some substantive benefits. Although financial firms continued to move to Midtown and Jersey City, the program, combined with lower-than-average rents, and attractions such as the nonprofit building at 120 Wall Street and the IT building at 55 Broad Street, drew new tenants including dot-coms and nonprofits to an area that had long been a financial-services ghetto. The high-flying dot-coms hit the ground hard; the nonprofits, however, came, contributed and stayed.

Even since September 11, although many of them were themselves economically hard-hit, nonprofits have proven to be both committed and constant. They helped bootstrap a declining neighborhood, and stuck around when the tough times unexpectedly returned. Who could ask for anything more?

Still, officials equate economic value with business, and business with payers of business income taxes—to such an extent that economic incentives are most often offered in the form of business tax credits and rebates. Nonprofits don’t pay business income taxes, which means they are often excluded from participating in incentive programs simply because of how these programs are structured—and unfortunately, the city seems to like it that way.

For example, the Relocation and Employment Assistance Program (REAP) provides as much as a $3,000 per-employee business-income tax credit to firms that relocate from Manhattan below 96th Street to qualified buildings anywhere else in the city.

Nonprofits are not eligible for this benefit, the city says, because they are already exempt from paying income taxes. Case closed, right? However, for-profit businesses that are operating at a loss, and therefore also pay no business income taxes, are given a direct grant instead of a tax break. In other words, if you are a failing dot-com that agrees to relocate to Harlem, or to one of the outer boroughs, the city will simply write you a check. In New Jersey, where nonprofits are eligible for benefits under a comparable relocation program, nonprofits receive credits against taxes they do pay-—their state withholding taxes.

A similar structural issue prevented nonprofits downtown from participating in the initial federal benefits programs after the September 11 terrorist attacks.

Why should nonprofits get economic incentives? After all, the city has argued, nonprofits already get plenty of money from the government. They don’t pay business taxes, so they don’t contribute to the city’s coffers. Plus, most nonprofits’ constituencies are local-—they have no incentive to leave the city, so why offer them incentives to stay?

While it is true that most nonprofits are unlikely to relocate out of state, some of the major national nonprofits can—-andhave. The United Negro College Fund, for example, moved its headquarters to Virginia. Others have gone to Washington, D.C., Baltimore, Chicago and, of course, New Jersey, taking jobs and services with them. And while local organizations are unlikely to move out of state, where they choose to locate within the five boroughs can have a strong impact on the success of the city’s economic development goals-—and that’s where some targeted benefits could make a big difference.

For example, unlike most for-profit businesses, nonprofits are looking for a reason to move to the outer boroughs or Harlem.

They poke around these areas regularly, hoping for bargains. What they are finding these days, however, is that in places such as downtown Brooklyn and Long Island City, rents are not only not a bargain, they are comparable to—-and in some cases higher than—-those in parts of Manhattan.

Take the case of one large nonprofit that was considering relocating to Harlem. The organization's leadership thought the move would be an appropriate expression of the group's mission and priorities, and there was a property in Harlem they found attractive. Then they learned the terms of the deal, and discovered that, without any incentives or benefits for the move, the deal was no better than those they were being offered in Midtown—-one of which they ultimately took.

Other organizations have had similar experiences, inquiring about Harlem or the outer boroughs, only to learn that they can stay in central, easily accessible Midtown for the same money. Downtown Brooklyn, in particular, would be a viable option for many groups if they could realize some significant savings for their efforts.

As in lower Manhattan in the mid-1990s, there are some incentives available to nonprofits that relocate to these areas-—but in this case they have not proven to be enough to make the difference. For example, the city offers several bond programs for nonprofits, but because of the high transaction costs often involved, these have been of use mainly to the largest organizations. And bond programs by their nature mean borrowing—-an increase, not a decrease to the bottom line.

Without access to the same incentives for which for-profit businesses are eligible, nonprofits find themselves largely priced out of the very neighborhoods the city is seeking to develop, and that is bad economic policy.

There are those who see the potential of nonprofits as economic development tools: For example, the Brooklyn Economic Development Corporation has begun to market the former State Workers' Compensation Building at 180 Livingston Street to nonprofits, in an effort to establish it as an economic development anchor there.

"We got involved in marketing the space for this building not only because we think it will help nonprofits to be clustered together," says Joan Bartolomeo, president of the Brooklyn Economic Development Corporation, "but also because the project serves our economic development mission to help revitalize downtown Brooklyn."

Nonprofits can help do this not only by supporting a retail base and creating a sense of activity and life around a neighborhood, but also by providing area residents with jobs, adds BEDC Real Estate Coordinator Margaret Nelson. "Nonprofits create more of a local employment base, which has its own multiplier effect, in terms of keeping money in our communities, and in the city."
It is still unclear whether the building will be eligible for benefits under the city's Industrial and Commercial Incentive Program—-one of the conditions for tenants to be eligible for REAP incentives. But even if it is, those benefits would be unavailable to nonprofit tenants.

Nelson thinks this is a mistake. "To the extent that the city is trying to use REAP benefits to help jumpstart certain areas, nonprofits may be more willing to be the first pioneers, and they are more price sensitive. They would be the most willing to take the risk, so I think it makes a tremendous amount of sense to offer them these benefits."

Skeptics argue that extending these types of economic incentives to nonprofits will merely open the giveaway goodie bag to thousands of new outstretched hands. But the truth is that the city is already under constant pressure to help nonprofits foot the bill for high rents-—in the form of funding hikes to organizations facing increasing overhead costs—-and in many cases it already does so. Making nonprofits eligible for a program such as REAP would both decrease the pressure and the paperwork, and would allow the city to target its dollars in a way that furthers its broader economic agenda.

In addition, there are ways to test the effectiveness of including nonprofits in such programs without encouraging a raid on the treasury. The city could experiment with a limited amount of money; it could set a cap on the amount of money available to any one organization; it could focus incentives on one particular area of the city at a time.

It is an experiment worth trying. Nonprofits have been and could continue to be a catalyst for neighborhood development in the city. If policymakers want to help new or struggling districts thrive, they should take nonprofits into account when structuring and marketing new incentive programs, and they should seriously consider amending existing programs such as REAP, to allow nonprofits to get into the game.

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