Learning From Adversity: The CDC School of Hard Knocks

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When East Side Community Investments in Indianapolis experienced a financial crisis and ultimately failed, a clear wake-up call rang for all who care about community development corporations (CDCs) and the work they do.[1] East Side had been one of the biggest and most productive CDCs in the country.

Previous studies of CDCs focused on their rapid growth and success across the country. The time has come, however, to take a close look at the failures and learn from them. East Side Community Investments was not unique. Our research into CDC failure led us to examine more closely four other organizations that failed, or were forced to downsize, and to draw lessons from their experiences so that other CDCs might avoid their fate.

Milwaukee: Community Development Corporation of Wisconsin (CDCW)

In the late 1980s Milwaukee's leaders in both the public and private sectors saw a need for a large developer of affordable housing. CDCW came into being in 1989 to develop small- to medium-sized apartment complexes in the predominantly African-American Northside area. Northside has the highest poverty rate in the city and many older housing units in need of repair. Facing political pressure from the city (its major funder), CDCW also took on properties from other CDCs that had gone out of business. Many of these properties needed repair and had problem tenants and low occupancy rates. CDCW staff spent considerable time turning these developments around.

By 1997 CDCW had developed 21 separate housing projects with a total of 722 units and managed the property for its own and other developers' rental complexes. The organization had a staff of 25 and an annual operating budget of more than $1 million.

Financial problems, however, also began to surface in 1997. For some time CDCW had been losing money on its property management operation; demand for housing in the Northside area was soft, tenant screening was inadequate, and personnel problems increased. Unable to compete effectively with the higher salaries and better working conditions offered by private management companies, CDCW had trouble keeping competent management staff. The financial losses did not create an immediate crisis, however, because the organization covered the deficit with funds generated from its multifamily development work.

In 1998 changes in city policies affected CDCW's development activities. CDCW built its staff to rehabilitate multifamily developments using the Low-Income Housing Tax Credit (LIHTC) program, but the city decided to focus its resources instead on the purchase, rehabilitation, and resale of single-family homes. The city allowed neighborhood organizations to determine how to spend community development block grant funds in their areas, and these groups drastically reduced the funding for affordable housing. CDCW could not keep up with the rehabilitation of single-family units and had difficulty selling units once they were rehabilitated. This combination of problems severely reduced CDCW's operating income and the red ink began to spread.

CDCW belatedly sought assistance, but could not secure funding. City officials thought the organization was too far in debt and unlikely to overcome its problems. CDCW asked its lenders to restructure their loans, but without city support the lenders were unwilling to do so. In March 1999 CDCW filed for bankruptcy and closed its doors.

Minneapolis: Whittier Housing Corporation (WHC)

The Whittier Housing Corporation was an offshoot of the Whittier Alliance, created in 1978 to revitalize Minneapolis's Whittier neighborhood. For the next 12 years the Alliance pursued its mission by sponsoring a variety of neighborhood improvement activities, including buying and rehabilitating multifamily housing developments.

In 1990 the Whittier Alliance was chosen to participate in the Neighborhood Revitalization Program, which provides $20 million a year for neighborhood development and improvement projects in Minneapolis. The Alliance developed a plan that provided additional affordable rental housing and social services for the area's lower income residents. Homeowners and private apartment owners got wind of the plan, however; they orchestrated a takeover of the Alliance and developed a plan that did not include rental housing. The new board had little interest in continuing to own and manage the multifamily properties the Alliance had developed during the 1980s, so it established WHC as a separate organization, transferring the properties—7 leasehold cooperatives with 16 buildings and 158 units.

Many of these buildings needed further renovation. WHC sought assistance from the Interagency Stabilization Group (ISG), a consortium of the city's major funders of CDCs. The ISG, however, would not provide funding without seeing a stabilization plan; when WHC complied, the plan was judged inadequate. Eventually, the ISG provided some support, but not enough for extensive rehabilitation. WHC staff also had difficulty finding effective property management companies, and the buildings continued to decline. At its height WHC had a staff of three—a director, a co-op organizer, and a secretary—and contracted with private asset and property managers. In 2000, after a final attempt to secure additional equity investments from the National Equity Fund, WHC went out of business.

SOUTH DALLAS: OAK CLIFF DEVELOPMENT CORPORATION

In 1987 the housing outreach program of a local Lutheran church formed Oak Cliff Development Corporation (OCDC) in response to an overwhelming demand for affordable housing in the South Dallas area. Since its inception, OCDC has focused on developing homeownership projects for low- and middle-income families with support from the region's financial and philanthropic institutions. In 1993 OCDC was made administrator for the Dallas infill housing program, which enabled the organization to focus on new construction of single-family homes. With adequate administration fees for the expanded services provided by the contract, OCDC hired additional staff. At its peak, OCDC had eight full-time staff members.

Even as OCDC flourished, however, several experienced staff members moved on to better positions, leading to project delays. The organization also had to contend with vocal community opposition—accompanied by unfavorable media and political attention—to its Independence Park Project, a planned development of 112 new homes. The most significant factor leading to the organization's downsizing, however, was the loss of the infill housing contract and the subsequent reduction of OCDC's operating budget.

The city elected not to renew OCDC's infill housing program contract when it expired. Caught unprepared, OCDC unsuccessfully appealed the decision. During this time, holding costs and legal fees drained the organization's reserves. Housing production suffered greatly, cutting into OCDC's income from developer fees. OCDC also could not find alternate sources of operating support and had to reduce its staff to an executive director and one part-time employee, greatly diminishing its production capacity.

PHILADELPHIA: ADVOCATE COMMUNITY DEVELOPMENT CORPORATION

Among Philadelphia's first CDCs, Advocate Community Development Corporation (ACDC) was founded in 1968. The organization, which completed its first housing project in 1971, also developed an area master plan that led to positive changes in public policy, including more financial resources for target neighborhoods. ACDC also undertook several larger housing projects and led a successful effort to designate the Diamond Street area the city's first historic district. By 1998 ACDC had completed 365 houses.

Throughout these years, the organization received widespread recognition for its work and was well supported by funders. Much of the organization's success came from the charismatic leadership of its founder, who served as president of the board of trustees until 1996. She was also de facto executive director; for most of her tenure ACDC did not have an executive director. During these years, the number of permanent staff members was kept to four or five. The organization relied on consultants and contract employees to supplement its staff.

ACDC began facing challenges when its founder developed health problems and could not devote the same time and energy to day-to-day activities. Staff members could not handle the complexities of development projects. After the founder resigned, the board found it difficult to provide leadership, especially after several other members resigned. Communication with funders suffered and ACDC lost much of its operating support, which led to staff layoffs. Several development projects stalled and became community eyesores.

ACDC struggled with the search for a new executive director. The first two choices did not work out, and illness cut short the tenure of the third. Development of new projects decreased, along with developer fees. Without adequate operating support, ACDC was forced to downsize its staff. Existing plans went unfinished, and for several years virtually no new projects were started.

DRAWING LESSONS

These four examples lead us to several suggestions for avoiding downsizing and failure.

1. **Develop and periodically revise strategic plans**. Two major problems the downsized and failed CDCs faced were changes in local housing markets and city policies. Strategic planning can help anticipate and respond to such changes. In Milwaukee the weakening demand for housing in CDCW's target area was at least partially responsible for the unexpected turnover and vacancy rates in the organization's rental housing portfolio. Similarly, a soft rental market in the Whittier neighborhood in Minneapolis did not allow for the rent increases needed to cover rising maintenance and repair costs. CDCs need to read the market and position themselves to remain competitive.

   Unanticipated changes in city policies also played an important role in the failures of CDCW and WHC and in the downsizing of OCDC in South Dallas. Strategic planning that assesses the political environment may help organizations anticipate, influence, and effectively respond to change. CDCs need to be involved in formulating, reviewing, and commenting on city policies that may affect them.

   Strategic planning is neither cheap nor easy, and many CDCs will need financial support and technical assistance to implement this critical exercise.

2. **Diversify activities, geographic areas served, clientele, and sources of funding**. CDCs must walk a fine line between diversification and specialization; a strategic plan should address how much it should do of each. Specialization requires a narrower range of staff expertise, which deepens with each new project, but which also makes an organization vulnerable to changes in funding priorities and community desires. Diversification makes an organization less vulnerable to those changes, but may lead to performance problems caused by a lack of staff expertise or financial resources.CDCs that failed or were downsized tended to have narrowly focused missions in terms of activities, geographic areas served, clientele served, and funding sources. For example, OCDC specialized in infill housing and WHC specialized in multifamily development. They had little to fall back on when local support for those activities evaporated.

In addition, CDCs that targeted small and/or homogeneous geographic areas were vulnerable to changes in market conditions in those areas. The units that CDCW and WHC owned and managed were concentrated in neighborhoods where the demand for housing decreased significantly. The CDCs could not raise rents to meet higher operating costs, and financial problems ensued. A larger, more diverse target area enables a CDC to diversify the location of its properties and reduces the organization's vulnerability to market weakness.

Housing very-low-income households typically requires deeper subsidies that are increasingly difficult to acquire, and CDCs that focus exclusively on such households may increase their financial vulnerability. In Minneapolis all of WHC's housing developments served very-low-income households that could not afford the rent increases necessary for proper building maintenance. A portfolio that includes housing for moderate-income households may provide enough revenues to cross-subsidize developments for very-low-income households and generate more community support.

CDCs that mostly rely on one funding source seem to be particularly vulnerable. Abrupt changes in the policies of city agencies, foundations, or other principal funders can leave CDCs with little time to find replacement funds. The CDCs in Milwaukee, Minneapolis, and Dallas all depended heavily on single sources of funding that left them in serious financial crises when that funding was interrupted. Diverse funding sources also provide CDCs more autonomy and some protection from the dictates of funders who want CDCs to adopt certain agendas or programs at the expense of local concerns.

The decision to diversify should be approached cautiously and involve both residents and the local CDC support community. Small CDCs just beginning to gain expertise in a given area may find that diversification is not possible or desirable. Becoming proficient in delivering or carrying out the group's core set of activities is important for all young CDCs. In addition, risks that may be associated with increased diversification may not be evident in our case studies; if not done carefully, and with sufficient resources, diversification may lead to poor performance and loss of funder or community support.

3. **Work hard to earn and maintain the support of residents**. A lack of community support for various CDC activities proved an important factor in the failure or downsizing of three of the organizations studied. In Minneapolis vociferous community opposition to the Whittier Alliance's focus on rental housing for very-low-income households led to the "takeover" of the Alliance

and the creation of WHC. Similarly, OCDC's plan in Dallas for a new 122-unit subdivision of affordable homes generated considerable community resistance and contributed to the loss of city funding.

Board members and staff need to build support for CDC activities by opening dialogue with community residents, involving them in the review of proposed activities, and inviting them to join committees. The board should periodically convene general meetings with the larger community and hold social events in those areas in which the CDC is developing projects. CDCs also must ensure that the properties they own or manage are well run and maintained.

4. **Pay more attention to training and retaining board members and staff**. In all four case studies, project development problems caused difficulties, including inaccurate financial projections leading to cost overruns, overly optimistic underwriting assumptions, inadequate cost control and accounting systems, and poor-quality construction. Within the four CDCs, property management problems also consistently appeared, including inadequate procedures to screen and evict tenants, inadequate property maintenance, and lack of social support services for tenants. Passive boards were another factor in organizational decline.

   The CDCs may have avoided such problems if staff and board members had received periodic training to provide strategic leadership and set policy guidelines for staff. We need to understand why many staff and board members do not take advantage of national initiatives to increase CDC capacity and to ensure they receive the training they need. In particular, we may need to provide access to tailormade, onsite consulting help. Perhaps the most important type of needed assistance could come from outside experts who could work with a CDC's board or staff on a range of issues or help sort through issues with funders.

   Many organizations found it difficult to retain experienced staff because city agencies and private sector companies pay substantially higher salaries. Organizations need to offer better staff salaries and benefits to increase retention, and they must plan for leadership transitions. Of course, public agencies and local and national nonprofit intermediaries can ensure competitive salaries and generally support CDCs by instituting programs that provide funds to cover core operating expenses. This support can be contingent on standards of productivity and professional competence.

5. **Maintain frequent and open communication with support community and respond quickly to problems as they develop**. Communication problems played a large role in all four case studies: problems between executive directors and their boards, between executive directors and funders, and between executive directors and city officials or politicians. When CDCs undertake potentially controversial projects, they would be wise to inform and involve local political leaders early in the process. CDCs that rely heavily on support from local government should be particularly aware of this need.

   Identifying and acknowledging problems as they arise also is important. CDCW management did not ask for help in addressing property management problems until the organization descended into deep financial trouble. Similarly, several of those interviewed in Minneapolis thought WHC should have dealt with its problems sooner and more decisively. Funders also should have stepped in sooner to provide the necessary support or find other organizations to take over the units.

The cases presented here signal some important warnings. Strategic planning that assesses the opportunities and threats in the local political and economic environment, and that assesses the organization's mission in light of changes, should be a standard practice among CDCs. Staff training and retention also help create effective and financially sound organizations. Ongoing communication with both the residents of the service area and funders also is critical to maintaining political and financial support. Finally, if CDCs do get into trouble, they must identify the problems quickly and reach out to their local CDC support communities for assistance. For their part, communities need to respond positively by helping CDCs work through problems so they can continue providing vital services to their communities.

Notes

[1] See www.nhi.org/online/issues/104/steinbach.html.

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