The collapse of Eastside Community Investments, one of the nation’s leading CDCs, provides important lessons and warnings to the growing CDC industry. Are CDCs doing an adequate job of analyzing and assessing risk in their activities - particularly in an environment where community development is becoming more competitive? Could a more proactive funding community have averted ECI’s financial problems? Are CDCs paying too little attention to issues of internal organization and management? And, beyond the management issues, how well can large for-profit ventures operate within nonprofit cultures?

MEETING A COMMUNITY’S URGENT NEEDS – OR GOING TOO FAST?

The Near East Side Community Organization, a coalition of churches and block groups, established ECI in 1976. By 1978, ECI was buying up vacant and boarded housing, making repairs, and selling the homes to families in its neighbourhood.

A period of rapid expansion began in 1984. That year, Dennis West became ECI’s new president. An Indianapolis native, West had served a stint as deputy administrator in the Indianapolis Division of Economic and Housing Development. During his first year at ECI, West helped the CDC establish a small business investment corporation to finance local enterprises, develop the ECI industrial park, begin rental housing production, and create a for-profit subsidiary - HCJ Corporation - to manage ECI’s housing portfolio.

But the community needed more. “At our 1987 board retreat, everyone started asking, ‘What are we going to do about children, youth, and education,’” West said. Residents wanted a savings bank, more sources of small business lending, and help with childcare.
ECI willingly accommodated. It created Eastside Day Care Homes Cooperative to train and license daycare providers and renovate their homes to satisfy state daycare codes. It started a micro lending fund to finance tiny enterprises and self-employment. It joined with the Indiana Alliance for the Mentally Ill to refurbish homes for the mentally ill. It launched a program of housing and support services for women and children escaping domestic violence. Working through the federal YouthBuild initiative, ECI began training high school dropouts in construction trades. And in 1992, it started another for-profit subsidiary, Arsenal Construction, to do general contracting and construction management, largely on ECI’s own renovations.

**DIVERSIFY – QUICK!**

It would be wrong to conclude that nobody saw financial danger lurking. As early as 1993, West and his board of directors began looking at ways to diversify ECI’s funding base. Like many large CDCs, ECI relied on developers’ fees generated by its housing projects to help subsidize its community building, training and economic support services. But competition for the housing tax credits that funded these projects had intensified. ECI could no longer automatically count on getting its proposals for tax credit projects approved by the state.

ECI began examining its core competencies to determine how to diversify. “We brought in Shorebank Advisory Services in 1994 to look at how we might build off of our lending expertise,” West explained. Because ECI’s real estate development in its own neighbourhood was already pretty well saturated, it looked at whether or not it could purchase property outside the community, renovate it, and sell it to generate profits. And it considered beefing up its construction activities by taking on wall paneling and truss manufacturing.

ECI’s leadership determined the community wasn’t a large enough market area to operate profitably the type of lending projects that Shorebank had recommended. The CDC then assembled a plan for buying property in another part of the state, but ultimately, the board wasn’t comfortable with that model. “In the hierarchy of things, our next best competency was construction,” said West. “So we started Shelter Systems. In the end, it proved to be problematic.”

Shelter Systems hit snags from the get-go. ECI had hoped to capitalize the new enterprise using a pilot CDC charitable tax credit approved by Congress in 1994. The credit had been passed at the urging of West, who wrote the draft bill, sponsored by then Indiana Representative Andy Jacobs. But ECI was not one of the 20 CDCs chosen to receive the $2 million in tax credits under the demonstration, and Shelter Systems’ launch had to be delayed.

More troubles followed. ECI presumed contacts within the Carpenter’s Union would help Shelter Systems get its products out quickly into union worksites, but sales were slower than anticipated. “Our costs were close to what we planned, but Shelter Systems got behind on revenues,” West noted.

Meanwhile, ECI was not winning as many housing tax credit projects as it needed to cover costs. The loss of developer fees was not insignificant. “We expected $1 million in fees that never happened,” said Phil Tom, former ECI Board chair. “Because of the way we structured our tax credit deals early on,” he added, “we were being killed financially by the debt.”

Next came the unanticipated departure of key members of ECI’s leadership team. A top staffer left for personal reasons. Then Mauro Mendoza, who directed ECI’s Arsenal Construction subsidiary – and was leading the roll out of Shelter Systems – died suddenly of pneumonia at age 42. Two months later, in February 1996, ECI’s Chief Operating Officer left. Hundreds of thousands of dollars of construction contracts that had been authorized never got entered into the accounting system. “Shelter System’s sales prospects were actually improving,” said West. “We had just secured a contract for a motel in Bloomington.” Shelter Systems was on track to start turning a profit within 12-16 months.

But ECI had no cash margin to wait out Shelter Systems’ road to profitability. By the end of 1996, ECI had been forced to sell Shelter Systems to Butz Construction, a tenant in the Nabisco plant, for $480,000. Butz hired Shelter Systems’ workforce, but the manufacturing venture ended up losing ECI at least $800,000. With Mendoza’s death, ECI also suspended operations of Arsenal Construction. To recoup some cash, ECI sold its small business investment corporation to Cambridge Ventures, which paid book value for the assets and assumed the fund’s $500,000 in outstanding liabilities. The sale generated proceeds of about $900,000.

**HITTING BOTTOM**

ECI cut its staff and shrank its operating budget. By mid 1997, however, the CDC was still bleeding cash at a rate of up to $100,000 per month. In July 1997, West announced he would be leaving after 13 years at the helm. In August 1997, a reorganization team led by former board chair Tom began downsizing rapidly. ECI’s budget plummeted to $350,000. The city injected about half a million dollars in operating support to keep programs going until they could be shifted elsewhere. The Lilly Endowment added another $300,000 infusion.

Most of ECI’s programs got transferred to other Indianapolis organizations and agencies. The neighbourhood savings program shifted to the Near Eastside Community Credit Union. Another nonprofit took over ECI’s housing services for the mentally ill - although ECI continued to manage the properties. The daycare co-operative and the domestic violence program shifted to other Indianapolis agencies. Gillette Construction bought ECI’s industrial park. The property management arm shut down. The city repossessed the Nabisco plant. An Indiana affiliate of the Small Business Administration agreed to assume ECI’s small business loan portfolio. And the National Equity Fund, a subsidiary of the Local Initiatives Support Corporation, began working with ECI to refinance some of its housing tax credit deals. About two-thirds of the ECI staff went on to other local agencies.

“The biggest victim of all this,” said Tom, “was our credibility.”
Some contend ECI might have been better off forming alliances and partnerships with other agencies to undertake community support services, rather than operating such programs internally. But what if those urgently needed community programs don’t materialize? Successful CDCs like ECI hear the constant drumbeat to do more and more in poor communities. Asking them to do less is probably not realistic.

By 1999, ECI’s full time staff was down to four - an asset manager, bookkeeper, and two staffers involved with ECI’s special needs housing. Serving as president was Ed Durkee, who had been ECI’s board chairman.

Shelter Systems, meanwhile, achieved the success ECI initially projected. By February 1999, Butz Construction, which bought Shelter Systems, had expanded to 57 employees and bought the Nabisco plant that ECI had to relinquish. “Butz is going gang busters,” said David James, an ECI board member.

ECI’s board and reorganization team are rebuilding using ECI’s development skills and property management capabilities as the base. ECI still owns 484 rental housing units - making it the biggest CDC in Indianapolis in terms of assets. In 1998, ECI sold 22 houses to new homeowners.

“ECI is going to stay in business,” James said. But gone is the vision of a major human services program for the neighborhood. Most funders have remained supportive. “Our colleagues in Indianapolis see us with envy and grief,” added Tom. “We still have a lot of good will in our community.”

COULD THE FALL HAVE BEEN AVOIDED?

“‘The reasons behind the collapse of ECI are still unfolding,’ wrote Robert O. Zdenek in a 1998 dissertation examining ECI’s woes and the lessons it offers. “While other CDCs have failed over the past three decades, the rapid dissolution of ECI is unprecedented due to ECI’s size, breadth, vision, creativity and leadership within the CDC world and at the city, state, regional, and national levels.”

ECI’s demise is the result of a confluence of factors - some major, others less important but contributing. Sorting out what mattered most is important to ensure the right lessons are passed on to other CDCs.

For example, how much did management shortfalls contribute to ECI’s woes? The answer is that they were a significant factor. “It wasn’t any structural problems or problems inherent with CDCs that caused ECI’s downfall,” one board member commented. “The reason ECI bottomed out was bad management pure and simple.” There was money to lose and a comfortable margin with which to take risk of Shelter Systems,” this board member added. “But the risk wildly exceeded what was a big margin to begin with. Once those risks were shown not to be good ones, the inefficient operations went on for years longer. Shelter Systems was a great idea – but it shouldn’t have been done by us. We should have partnered with Butz from the beginning.”

ECI also had inadequacies in its management and information systems. “An issue that surfaced repeatedly in the field interviews of ECI staff and outsiders was the difficulty in accessing timely and accurate financial data,” Zdenek said. “ECI seemed to be in a constant position of upgrading software packages.”

Loose management controls also had some impact. “Details were so neglected at ECI, a former employee recalls, the organization at least twice neglected to file one-page forms that would have qualified it for $10,000 tax abatements for a housing project,” the Indianapolis Business Journal reported in May 1998. ECI’s Board Chair Ed Durkee told the newspaper that no one knew precisely how $1.5 million plowed into the Nabisco plant renovation had been spent.

Another contributing factor may have been poor scrutiny by outside funders. “We never spotted the problems on ECI’s audits,” said a CDC practitioner who worked for an intermediary that came in later to determine what had happened. “Some recoverable grants - no interest loans - were being listed as assets by the auditors. But they aren’t assets. If you don’t perform, they’re liabilities.”

Some analysts have contended that ECI’s board wasn’t watching carefully enough and that this caused the CDC’s demise. In fact, while the complexity of ECI’s finances made it difficult for the full board to understand the financial picture, an active board committee had been trying to grapple with the failing financial situation. A more significant problem may have been the board’s inability to challenge or overrule West, who was highly popular in the community and strengthened by ECI’s prior successes. There was also a misunderstanding among board members of where ECI’s revenues came from. “We thought we made money from all these apartments we controlled,” a board member commented. In fact, ECI lost money on its real estate management but earned revenues from developer fees. “People didn’t realize the apartments we built were never intended to make money on their operation,” the board member noted. Some believe that misunderstanding at the board level may have enabled ECI to get risky real estate projects approved.

Clearly, among the major factors were the unanticipated staff departures that decimated ECI’s top ranks. “We went from having a critical mass of staff competency to not having it - just like that,” said West. Another major factor was ECI’s failure to adapt fast enough when its revenue sources looked to be drying up. A lot of the damage could have been reduced if ECI’s downsizing had happened faster. “The near fatal flaw for ECI was how we reacted to our troubles,” a board member noted. “The problem isn’t just taking risk - but stopping soon enough.”

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A RISKIER WORLD

Community development practitioners worry that financial woes similar to ECI’s could crop up soon in other CDCs - especially larger organizations with diverse holdings and multiple community building activities. A handful of groups - National Temple in Philadelphia and Peoples’ Housing in Chicago, for example - collapsed before ECI.

There’s growing concern that existing support networks for CDCs simply aren’t looking for early warning signs of financial trouble - and aren’t able to step in to help a CDC before the problems have become overwhelming. CDC supporters also worry that the human needs in poor communities will continue to pressurize them. Asking them to do less is probably not realistic. “We knew ECI’s expansions could be risky while they were happening,” James said. “But there were so many needs in the community. Nobody else would do it if ECI didn’t. And Dennis had solid plans.”

The most significant factor in ECI’s troubles was its strategic misjudgment about Shelter Systems. Should ECI have been more aware that profits might materialize slowly in the highly competitive construction industry, with its razor thin margins? Shelter Systems lacked a distribution network and, as a small firm, couldn’t buy its lumber supplies at the same discounted rate offered to higher volume competitors. Its workforce, partly made up of younger workers and trainees, may have been at a competitive disadvantage when vying with experienced tradesmen at other firms.

West disagrees. “Shelter Systems worked,” he says, “it just didn’t work during the time period we had it.” West says he was satisfied with the company’s training component and felt Shelter Systems had good productive workers. “Obviously with what Butz has accomplished with the machinery, location and management team, a lot of the elements of the business plan were on target.” Even the most thoughtful business plans, however, rarely project the precise trajectory of a new enterprise. ECI made an all too common mistake: assuming profitability would occur sooner than it did.

Is community development simply becoming a trickier and more competitive business? CDCs once had free run of the landscape of distressed communities. Today, competition to redevelop in these communities is intensifying as CDC ranks grow and more private sector competitors spy profit potential in lower income areas. It may be that the margin for mistakes is getting thinner. If so, all CDCs will need to upgrade and adapt their decision making, risk assessment, and management systems to accommodate the new era. Otherwise, more CDCs will almost surely meet the same fate as ECI.

RESOURCES


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