MANAGEMENT CONTROL IN A COMMUNITY DEVELOPMENT CORPORATION

A Case Study:

The Chinese Economic Development Council

by

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B.S., University of Southern California (1980)

Submitted to the Department of
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ABSTRACT

A case study was conducted on the managerial control of the Chinese Economic Development Council (Housing and Land Development Division) over programs and operations. Both financial and nonfinancial factors were examined. The discussion presumes a working knowledge of basic financial and accounting concepts, the real property development process, and of federal and Massachusetts' programs that fund community development activity.

The results of the evaluation state that managerial control over operations was generally good, but control over programs is tenuous. Recommendations for improvement in managerial control are proposed.

Thesis Supervisor: Frank Sidney Jones
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Preface

This document is a case study of managerial control in the Housing and Land Development Division of the Chinese Economic Development Council, a community-based organization headquartered in Boston's Chinatown. It is written as a client-oriented document, i.e. as an evaluation of and develops recommendations to the Chinese Economic Development Council, towards the end of improving future organizational performance. However, the case may be useful and relevant to other nonprofit agencies, particularly those involved in local-level community economic development. The discussion presumes a working knowledge of basic financial and accounting concepts, the real property development process, and of federal and Massachusetts programs that fund community development activity.
Table of Contents

I. Introduction.................................................. 4

II. Description of the Chinese Economic Development Council...........................................10

III. Evaluation of the Housing & Land Development Division...........................................14
   A. Program Management........................................15
      1. Oxford Street Project....................................15
      2. 31 Beach Street Project..................................32
   B. Operational Management.....................................35
      1. Financial Accounting.....................................35
      2. Financial Controls Over Spending........................37
      3. Information Systems......................................39
      4. Budget Preparation........................................42
      5. Operational Auditing......................................44
      6. Operating Capital Maintenance............................45
      7. Behavioral Considerations................................46
   C. Performance With Regard to Non-profit Constraints.................................49

IV. Organizational Response to Environmental Pressures........51
   A. New Organizational Structure...............................51
   B. Impact on Operating Activities..............................51
   C. Recommendations...........................................52

V. Bibliography....................................................55

VI. Appendixes.....................................................56
Introduction

Economic development is the process through which members of a society, through collective action, increase the level and quality of their material and social well-being over time. Community-based economic development assumes that involvement of community residents is one of the critical changes in existing institutional structures that is necessary in the development process. In the eyes of residents of low-income communities, community-based efforts are necessary to overcome distributional inequities and uneven development in the national economy. In terms of overall urban development, community-based efforts provide a third sector in the development process, which is able to avoid some of the limitations faced by both the public and private sectors.

As noted by Belden Daniels (1), the concept of involving residents of low-income communities in the economic development process - usually through community-based organizations - is relatively young, originating in the mid-1960's. Because of its short history and inconsistent

public-sector commitment, it is difficult to assess the ultimate potential of community-based development efforts. It is clear, however, that many of the promises of community-based economic development have not been met.

Both Belden Daniels (2) and Paul Pryde (3) cite managerial capacity as one of the most critical factors in the development process. Without the capacity to produce, all other resources and intentions are merely "latent, untapped potential." "The lack of management skills or organizational capacity is probably at the root of the vast majority of unsuccessful community-based development efforts."(4).

Two of the most important tasks facing managers are planning and control. Planning involves deciding on what should be done and how to do it, and control is assuring the desired objectives are attained. Anthony and Herzlinger identify three types of planning and control processes prevalent in most organizations: strategic planning,

(2) Ibid.


operational control, and management control (5). This thesis will focus mainly on the management control process within a community-based organization in downtown Boston.

In the management control process, the goals and strategies arrived at in the strategic planning process are accepted as given; management control focuses on the implementation of the strategies. This process does not involve the daily operating decisions that are the focus of operational control, but it does aim to ensure that these operations are carried out properly. "Management control is defined as the process by which management assures that the organization carries out its strategies effectively and efficiently."(6)

There are four principal steps in the formal management control process: 1) programming, 2) budgeting, 3) operating and measurement, and 4) reporting and analysis. Such a system embraces all aspects of the organization's operations so as to assure that all parts of the operation are in balance with each other. It is also helpful if the system encourages goal congruence, i.e. is structured such that goals of individuals within the agency are consistent with


(6) Ibid.
organizational goals. Furthermore, a good management control system is usually related to its financial structure, in order to provide a "unifying core" around which other types of information can be related.

There are, however, certain characteristics of non-profit organizations that affect the management control processes in those organizations. Some of the most important ones include (7):

1. Problems are created by the absence of a satisfactory, single, overall measure of performance that is comparable to the profit measure used in for-profit enterprises. Performance measurement, centralization of decisions, comparisons between units and between costs and benefits, and management control is much more difficult to attain or measure as a result.

2. Most nonprofit organizations - because of a heavy dependence on a constrained funding base - have little freedom to choose the types of activities in which it will engage, and the ways in which it will compete in that (those) industries. Nor can they usually change those strategies if management decides that a change is desirable.

3. Some nonprofit organizations are 'public-supported', i.e. they receive a significant amount of financial support from sources other than revenues from services rendered. There is usually no connection in these agencies between the services received and the resources provided, complicating future planning regarding the level of production of goods and/or services.

(7) Ibid., pp. 34-50.
In addition, the lack of direct accountability to the client can virtually eliminate the motivations associated with market forces (and incentives to use resources wisely).

Furthermore, as a substitute for the market resource allocation mechanism, managers must compete among themselves for scarce resources. This is further complicated by the parallel necessity to satisfy the demands of those providing resources to the agency.

4. In many nonprofit organizations, the governing board is designed to represent the public (or respective community's) interest. However, decisions that protect the public interest are much more difficult to reach than the course of action that will lead to increased profits in a for-profit firm. This could lead to a lessening of influence of the governing board in a nonprofit agency.

5. An additional characteristic of most public-supported organizations is the relatively low monetary compensation of top management. This is probably due to a lack of understanding on the part of the public and those who control fund sources of the importance of the management function, and the use of compensation as a motivating device. This deficiency is compounded by the belief that non-profit organizations should not use bonuses or other types of incentives.

6. Nonprofit organizations, for the most part, are still practicing 19th-century-era fiduciary accounting. They have not "grown with the times" and adopted some of the 20th century accounting and management control concepts. These new practices could furnish additional useful information about the business both to parties external to the organization and internal management. These concepts include the accrual concept, cost accounting, standard costs and variance analysis, budgeting, responsibility accounting, and programming.
Essentially, this paper will examine the administrative and coordinative capacity of the Chinese Economic Development Council in dealing with financial and general management problems encountered in its economic development efforts. For the sake of simplicity, I will examine one division (Housing and Land Development) of the agency; the types of projects developed and organizational methods of implementing them are assumed to be representative of the agency as a whole.

The Housing and Land Development Division consists of one line manager, responsible for two projects. The "Oxford Place Project" is a 39-unit family housing proposal to be located on Oxford Street, approximately one-half block from the heart of Boston's Chinese Business District. The other project, "31 Beach Street", is an 11-story office building acquired by CEDC in 1979 for income-generating purposes (and possible subsequent development into low-income housing). My evaluation of this division assumes two forms: 1) that of an efficiency evaluation by examining day-to-day operational management, and 2) a (results-oriented) project management effectiveness review.
Description of the Chinese Economic Development Council

The Chinese Economic Development Council (CEDC) is a nonprofit, tax-exempt, community development corporation funded by the Office of Economic Development (housed in the Community Services Administration of the federal government). CEDC's mandate is to improve the socio-economic conditions of the Chinese-American community in the Greater Boston area as well as to preserve, share, and enhance its cultural heritage. CEDC began operations in June 1975 with venture capital and administrative funds granted by the Community Services Administration (CSA) under Title VII of the Community Services Act of 1974. Although CEDC focuses its economic development efforts on Boston's Chinatown, South Cove, South End, Combat Zone and Leather District, its areas of concern and program initiatives extend to the larger Chinese-American community in metropolitan Boston.

CEDC programs are carried out by its three divisions: Business Development, Community Development, and Housing and Land Development. The Business Development Division identifies industrial and commercial investment opportunities that will return income to CEDC's special impact area, create jobs for its residents, and provide ownership opportunities for local entrepreneurs.

The Community Development Division coordinates
community, government, and business resources to meet the objectives of CEDC's community development programs: a Newcomers Services Center, a Manpower Development Program (including a Chef Training Program), a Language Laboratory, and a Center for Chinese Arts and Culture.

The Housing and Land Development Division (upon which this thesis is focused) identifies, evaluates and develops real estate investment opportunities to benefit Chinatown residents, particularly in the area of housing. This Division works in tandem with CEDC's for-profit subsidiary corporation, CEDC Realty Corporation, that holds title to two properties: 31 Beach Street and Oxford Street. (CEDC controls this subsidiary both financially and legally, through ownership of 100% of CEDC Realty Corporation stock, and through the composition of the Board of Directors.)

CEDC utilizes the "community approach" to economic development. However, like many other non-profit community-based enterprises, CEDC must overcome structural problems constraining profit-seeking enterprises. The organization must deal with the barriers endemic to its non-profit and government-supported nature. Its problems are further exacerbated by the changing funding priorities of the current Administration and the difficult national economic climate as of late.

A major consequence of federal budget-cutting for the CEDC is the elimination of 100% of its operating and venture
capital funding from the Community Services Administration, effective September of 1982. In order to facilitate a self-sufficiency status from the OED Title VII funds, the CEDC has developed a strategic plan to serve as a conceptual framework to guide the organization in the medium and long-term future. Its mandate will remain intact, but specific organizational priorities and strategies are under revision. The pressures of immediate survival have necessitated an assessment of existing assets and evolving ventures which emphasize the likelihood of generating administrative funds and equity funds, and takes the form of a major reorganization.

The new administration is designed to clearly separate competing responsibilities and establish specialization in certain activities. The organization is to be separated into the Development, Accounting, and Operations Divisions. The Development group will remain responsible for all facets of development until such time as income is produced by a venture. The Accounting group will continue to monitor and produce financial statements for both development and operations on a regular basis. The Operations group will assume responsibility for income-producing ventures under an orderly transition procedure developed under the control of the administration.

Under the old structure, both the 31 Beach Street and Oxford Street projects were the responsibility of the
Housing and Land Development Division. Under the proposed reorganization plan, the 31 Beach Street property would come under the purview of the Operations Group because it is a stable, income-producing venture. The Oxford Street project, however, would be placed with the Development Group until such time as the project is financed, constructed, occupied, and producing steady revenues.
Evaluation of the Housing and Land Development Division

The essential difference between an operations evaluation and a program evaluation is that one is an evaluation of process (it focuses on an organization's efficiency), and the other is an evaluation of results (and focuses instead on an organization's effectiveness). Sometimes called a "zero-base review," an operations evaluation involves examining each function from scratch, rather than utilizing the existing spending level as a base. For managerial control purposes, Anthony and Herzlinger suggest this review perhaps be conducted once every four or five years in order to determine how to conduct more efficiently the agency's activities.

A program evaluation, on the other hand, should be conducted less frequently, due to the significant amount of staff time required to undertake such an evaluation (8). No less important than an operations review, there is a periodic need to determine whether benefits of particular programs continue to exceed its costs, and whether any methods could be employed to improve its effectiveness.

(8) Ibid., p. 151.
Program Management Evaluation

A program evaluation involves an identification of the program's objectives, and then a judgment as to the degree to which those objectives were attained. In addition, the issue of whether the benefits of a particular program exceed the costs must be explored. In my evaluation of the Housing and Land Development Division's management of its two projects, both monetary and non-monetary evaluation measures are utilized. Both types of criteria are necessary to include because of the way those projects are structured, and because inclusion of both measures produces a more useful evaluation model (that can more easily be applied in other nonprofit situations).

Oxford Street

Project Description

The Oxford Street project is a 39-unit family housing proposal located on Oxford Street, approximately one-half block from the heart of Boston's Chinese Business District. It consists of a vacant building formerly part of the New England Telephone Company switching station at Harrison Avenue, and a vacant parcel of land that has been collecting debris, garbage, and illegally parked cars for more than twenty years. The proposal utilizes a number of government
programs: Department of Housing and Urban Development
Section 8 housing subsidies for all 39 units, Federal
Housing Administration Insurance, Massachusetts Housing
Finance Agency construction and permanent loans,
Massachusetts Community Development Block Grant funds and
Chapter 121A Tax Agreements, and equity financing from the
Community Services Administration.

The vacant land and building are surrounded by
residential and community area along Oxford Street and
Oxford Place. The buildings along Oxford Place are all 4-5
story residential structures while the buildings along the
other side of Oxford Street contain a Chinese school, an
auditorium, and the offices of the Chinese Consolidated
Benevolent Association. Further along Oxford Street are
groundfloor areas such as an ice cream store, a Chinese
printer, a beauty shop and a grocery store, all of which
have apartments above them. The streets surrounding the
vacant building contain all necessary services and public
utilities; it is located one-half block from the
restaurants, stores, and community facilities that are the
fabric of Chinatown.

The building to be renovated for 39 units of family
housing is of brick and steel fireproof construction with
concrete floors. It is presently a four-story building,
however, the high ceilings of the first and fourth floors
will allow for the removal of the existing first floor and
roof, and the construction of a new first, second, fifth, and sixth floors. This will allow for the development of 39 family housing units instead of 28 to 30 units, save valuable space in the building that would otherwise be wasted, and make the project more feasible economically.

The vacant parcel of land will be developed as a sitting park and a pedestrian way connecting Oxford Place to Oxford Street. There are no such amenities anywhere in Chinatown at the present time. In addition, CEDC has received assurances from the Neighborhood Development Agency that they regard Oxford Place as a high priority project, and will attempt to provide adequate funds for reconstruction of the street and sidewalks.

Form of Ownership and the Development Team

Oxford Place Associates is a limited partnership between CEDC Realty Corporation and CEDC, Inc. (the non-profit) for the purpose of developing and investing in real estate in the City of Boston. The purpose of this structure is to allow the Realty Corporation to develop, own, and manage real estate assets for the parent corporation so that the parent will have the strong financial base necessary to participate in federal and state programs required to undertake large scale housing and development programs.

In this project CEDC Realty will be the general partner and will have a 2% interest in the partnership, while CEDC,
Inc. will be the limited partner and have a 98% interest in the partnership. CEDC, Inc. will bring to the partnership the land and buildings to be developed as the Oxford Place Project, and will transfer title to this property to the CEDC Realty Corporation.

CEDC, Inc. will then become the withdrawing limited partner when the Oxford Place Project is syndicated and will use the syndication proceeds as funding for other community development programs. CEDC Realty Corporation will remain as the general partner in Oxford Place Associates and will retain responsibility for developing and managing the project as required by the Department of Housing and Urban Development and the Massachusetts Housing Finance Association.

The other members of the development team are as follows:

1. General Contractor: Barkan Construction
2. Architect: John Sharratt Associates

Goals and Objectives

Since actual project output is, or at least should be, related to an organization's objectives, the first step toward output measurement should be an examination of the goals of CEDC in general, and of the Housing and Land Development Division in particular.

The development activities to take place in downtown Boston in the next several years pose direct threats to
Chinatown in two ways. First, the land uses represented by current development (on the part of private parties and the City of Boston) conflict with the residential nature of Boston's Chinatown and remove scarce available land resources from future community uses. Second, the expected investment of from $390 million to $1.4 billion in these projects is contributing significantly to escalating land prices (9).

The Housing and Land Development Division of CEDC addresses the need for greater utilization and community control of land for the benefit of Chinese residents. The following goals are stressed: (10)

1. To increase land control.
2. To increase the quantity and quality of the housing stock.
3. To increase the quantity and quality of commercial space.
4. To increase the quantity and quality of industrial space.
5. To provide Chinese people with the opportunity to live and work in Chinatown.

Although it is clear that goals are statements of intended output, they are normally not quantified, and therefore

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(10) Ibid.

- 19 -
cannot be used directly as a basis for a measurement system.

An objective is a specific result to be achieved within a specified time period, and can be a more useful tool towards output measurement. Therefore, I have attempted to translate the goals (listed below) of the Oxford Place Project in particular into reasonable objectives, given CEDC's resources and priorities.

<table>
<thead>
<tr>
<th>Goals</th>
<th>Objectives</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. To increase the quantity and quality of the housing stock.</td>
<td>1. Provide housing within 5 years that:</td>
</tr>
<tr>
<td></td>
<td>a. Is affordable to the majority of Chinatown.</td>
</tr>
<tr>
<td></td>
<td>b. Is &quot;up-to-code.&quot;</td>
</tr>
<tr>
<td></td>
<td>c. Is appropriately sized.</td>
</tr>
<tr>
<td></td>
<td>d. Partially fulfills the housing demand.</td>
</tr>
<tr>
<td>2. To increase land control.</td>
<td>2. Purchase (or obtain long-term leases or options to) parcels of land within or abutting Chinatown.</td>
</tr>
<tr>
<td>3. To create a strong physical image that will enhance the attractiveness and visibility of Chinatown.</td>
<td>3. Build a project that is architecturally attractive; provide appropriate amenities.</td>
</tr>
<tr>
<td>4. To provide opportunities for Chinese people to enter the construction trades.</td>
<td>4. Secure commitments from general contractor that a significant number of Chinese persons will be employed on the project.</td>
</tr>
<tr>
<td>5. To provide the opportunity for Chinese people to live and work in Chinatown.</td>
<td>5. Provide housing or job opportunities for Chinese persons within or nearby Chinatown.</td>
</tr>
</tbody>
</table>
6. To remain financially solvent.

6. Enter into a project that will:
   a. At least "break even," given reasonable estimations of the cost of capital.
   b. Not expose CEDC to unreasonable amounts of risk, both financial and nonfinancial.

7. To generate capital for future projects.

7. Syndicate project for maximum financial returns, as quickly as possible.

Performance Measurement

The most useful way to measure performance, given these complex goals and objectives, is through the use of an output vector. Essentially, an output vector is an array of indicators, aggregated to provide patterns, trends, and indicators of output quality and organizational performance (11).

In order to evaluate the project's efficiency and effectiveness (under current management), I used a method described in Anthony & Herzlinger's Management Control in Nonprofit Organizations (12), in which a standard numerical


(12) Ibid.
measure of achievement is developed. The real line \((0,1)\) represents a failure/success continuum, where \(0=\) complete failure and \(1=\) complete success. The point \(0.6\) was designated the minimum desirable level of achievement (the target); any score in excess of \(0.6\) would show the degree to which a target had been surpassed. A score of \(0.4\) was taken to indicate that the project would potentially fail an objective; any score below \(0.4\) would show a proportionally greater degree of failure. The interval \((0.4, 0.5)\) represented a "blurred region" suggestive of failure and \((0.5, 0.6)\) a "blurred region" indicative of success (See Table 1 attached).

The measures used in this assessment regime are primarily "results measures," i.e. measures of output expressed in terms that are related to the Division's objectives. The value weights placed on each component of this output vector (the last column on the attached chart) reflect "my best guess" of the values of the staff at CEDC. A "4" represents a high priority target and a "1" represents a low priority.

Take the first objective, "provide housing," for example. The first target stated is for the housing to be provided within a five-year time span, starting from the beginning of the planning stage. Moving to the "outcome measure" column, our scale indicates that a 0.4 signifies that the housing would not be provided within this time
## Potential Project Effectiveness Vector

<table>
<thead>
<tr>
<th>Objective</th>
<th>Assessment Regime</th>
<th>Outcome Measure</th>
<th>Weight</th>
<th>Outcome</th>
<th>Achievement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provide housing</td>
<td>Within 5 years</td>
<td>$x = 0.4$ if no $= 0.6$ if yes $\text{Achievement} = x$</td>
<td>4</td>
<td>Yes</td>
<td>0.60</td>
</tr>
<tr>
<td></td>
<td>Is &quot;up-to-code&quot;</td>
<td>Same as above</td>
<td>1</td>
<td>Yes</td>
<td>0.60</td>
</tr>
<tr>
<td></td>
<td>50% of units at</td>
<td>Portion of units provided that have at least 2-bdrms.</td>
<td>2</td>
<td>44%</td>
<td>0.53</td>
</tr>
<tr>
<td></td>
<td>least 2-bdrm. size</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>100 multi-family</td>
<td>$= 0.2$ if 30 uts. $= 0.4$ if 50 uts. $= 0.6$ if 100 uts. $= 0.8$ if 150 uts.</td>
<td>2</td>
<td>39 units</td>
<td>0.30</td>
</tr>
<tr>
<td>Purchase or lease land in Chinatown</td>
<td>Purchase by 1980</td>
<td>$x = 0.4$ if no $= 0.6$ if yes $\text{Achievement} = x$</td>
<td>3</td>
<td>Yes</td>
<td>0.60</td>
</tr>
<tr>
<td>Build an attractive project; provide amenities</td>
<td>Have top archit. firm as designer</td>
<td>Same as above</td>
<td>1</td>
<td>Yes</td>
<td>0.60</td>
</tr>
<tr>
<td></td>
<td>Provide amenities</td>
<td>Same as above</td>
<td>1</td>
<td>Yes</td>
<td>0.60</td>
</tr>
<tr>
<td>Employ Chinese in construction trades</td>
<td>Secure commitment from general contractor</td>
<td>Same as above</td>
<td>1</td>
<td>No</td>
<td>0.40</td>
</tr>
<tr>
<td>Remain financially solvent</td>
<td>At least &quot;break-even&quot; at weighted cost of capital</td>
<td>Same as above</td>
<td>4</td>
<td>Yes</td>
<td>0.60</td>
</tr>
<tr>
<td></td>
<td>Minimize expenses: obtain 121A tax agreement</td>
<td>Same as above</td>
<td>2</td>
<td>Yes</td>
<td>0.60</td>
</tr>
<tr>
<td></td>
<td>Minimize risk: obtain Section 8 rent guarantees</td>
<td>Same as above</td>
<td>2</td>
<td>Yes</td>
<td>0.60</td>
</tr>
<tr>
<td>Syndicate project for maximum returns</td>
<td>Net at least $300,000</td>
<td>Same as above</td>
<td>3</td>
<td>Yes</td>
<td>0.85</td>
</tr>
</tbody>
</table>
period, and a 0.6 that the housing would indeed be provided within five years. The outcome of the evaluation was "yes," i.e. the housing would be provided within this time frame. Thus, the "achievement" of this target is a 0.60, indicating that the project is effective in meeting one of the organizational goals of CEDC. This particular target has a weight of 4, signaling that this is one of the highest priorities of the organization.

Referring to the following table, you can clearly see that this project would attain to a significant degree the goals that have been articulated for it. Of the twelve goals, nine of them are projected to achieve at least a 0.60, its minimum target level of achievement. The three that are projected to achieve less than this target level are not the highest priorities to the organization (given a weight of 2 or 1). Although it would be desirable to achieve these other targets, it is not as important to the organization as those targets with a weight of 3 or 4.

It is possible to devise a singular measure of total project effectiveness, should the reader decide one is both necessary and valid. To do so, the following equation would be appropriate:

\[
\frac{\text{(sum of all target weights)} \times \text{(target achievement level)}}{\text{sum of each (target weight)} \times \text{(respective achievement level)}}
\]

For this project, the numerator of the equation would be 15.41,
i.e. \[
[(4)(.6) + (1)(.6) + (2)(.53) + (2)(.3) + (3)(.6) + (1)(.6) + (1)(16) + (1)(.4) + (4)(.6) + (2)(.6) + (2)(.6) + (3)(.85)] = 15.41.\\]

The denominator would be 15.6, i.e. (26)(0.60). Therefore, the total "effectiveness rating" for the project would be 15.41/15.6, or 99%. However, I do not feel such an overall singular number is valid in attempting to measure effectiveness, because it implies a methodological precision that has just not been attained.

Other types of output measures could also have been included in this output vector, of course. For example, one productivity and efficiency measure of the "provision of housing" objective could be to calculate the following ratio: monetary value of housing produced/CEDC's equity contribution to the project. This would measure how efficiently this project attains its objectives. However, the usefulness of this measure could be called into question, due to the idiosyncracies of this particular project. For example, land in Chinatown is extremely expensive compared to other areas of Boston. Second, the rehabilitation costs of this project are extremely high because of the numerous logistical problems involved. As a result of these two factors, the "cost per unit" projections for this project are extremely high, producing a distorted -- and therefore relatively useless -- efficiency rating.

Another measure of productivity could have been devised for the employment objective: number of man-years-worth of
jobs that this project created for Chinese persons, compared to the number of man-years that were required to get this project accomplished. Unfortunately, there was insufficient information to predict project success in this regard.

The last type of tool that could have been used was social indicators. Social indicators are broad measures of output which are significantly the result of the work of the organization. In this case, indicators such as the reduction in housing overcrowding or the amounts of income redistributed with regard to Chinatown may have been examined. The serious deficiency with this is that although these indicators reflect the activities of the Housing and Land Development Division, they are also affected by numerous and complex exogenous forces. General unemployment, environmental influences, and inflation could significantly affect these indicators. Using these measures without recognizing the effects of these factors could result in some erroneous conclusions regarding the effectiveness of the organization (and the 'effectiveness potential' of this particular project).

Conventional Real Property Financial Analysis

The project is financed through three sources: 1) cash expended for project feasibility studies, previous to project approval and loan negotiations, in the amount of $103,141; 2) equity contributions required of CEDC by MHFA
(for loan approval) of $566,930; and 3) a 30-year permanent loan from MHFA to CEDC in the amount of $1,837,831 (refer to Appendix A). In terms of "pure capital costs," however, the value of the building after rehabilitation is $2,342,961 (loan + equity required by MHFA – value of the land). Based on projections by the general contractor of project costs (Appendix B) and operating expenses (Appendix C), the project generates a before tax cash flow of $12,253 in the first year (Appendix D).

Further analysis reveals the following purchasing and operating comparables (Appendix D):

1. Price/unit: mortgage amount/unit = $47,124 : mtge. + equity contrib./unit = $61,661
2. Total operating expenses/unit = $2,161
3. Operating expenses/gross revenue per unit = 24.60%
4. Real estate taxes/gross revenue = 12%
5. Average monthly rent per unit = $730.82 (paid by the tenant and HUD)
6. Estimated project occupancy = 99%

The price/unit and monthly rent/unit may seem a little steep; this is primarily attributable to the unusually complicated, and therefore more expensive, rehabilitation requirements. In addition, under normal circumstances, a 99% occupancy level would be considered unreasonably optimistic. Given the 'financials' of this project, a 95.42% occupancy level would be required merely to "break even." However, all units in this project have been
designated HUD Section 8 eligible. This makes the occupancy levels and rents receivable almost risk-free for a number of reasons: there will always be low- and moderate-income persons eligible for the project, such tenants will only have to pay up to 30% of their income in rent, and the remainder of the rent will be paid by the federal government. Risks of foreclosure (Appendix E) are also almost negligible for the same reasons.

Projected cash flows for the project are delineated in Appendix E. A "weighted cost of capital" was utilized for discounting cash flows to obtain a net present value for the project of $197,000 (this assumes a 15-year time horizon, and that the project is not sold at the end of that time). The discount rate of 9% was calculated by combining the cost of CEDC's sources of funds for this project: 1) 4.11% financed at 0% (in-house operating capital, and restricted such that there are no opportunity costs associated with it); 2) 22.61% financed at 6% (venture capital that has a 6% opportunity cost); and 3) 73.48% financed at 11% (debt to be issued by MHFA for this project). Cash inflows stem from three sources: 1) after tax cash flows, 2) developer's profit, and 3) proceeds from syndication of depreciation tax shelters.

The project will net approximately $450,000 in syndication proceeds. Not only does this structure still retain ownership of the land, but it generates cash that can
then be used for further community development projects.
Since the majority of tax benefits that accrue from the
accelerated depreciation treatment could not be fully
utilized by CEDC Realty, the sale of them represents no loss.

After examination of the total costs and benefits, and
the Realty Corporation's cost of capital, the most feasible
course of action is to hold on to the property past the
15-year time horizon previously articulated by the project
manager. Due to a combination of factors (the high mortgage
amount, the accelerated depreciation schedule, and the low
sale price based on capitalized rental income), sale of the
asset at this time would result in a net loss of $104,101.
Sale of the property at this time without "losing money"
could only be possible if the land value increased nearly
1000% -- clearly an unreasonable expectation.

It is clear that, overall, given CEDC's programmatic
objectives, the Oxford Place project is a sound investment
(refer to Appendix G). The project returns nearly 9% of net
operating income (capitalization rate analysis); given a
15-year time horizon, all equity contributions are recouped
on both a simple and discounted (9%) analysis; and the
project produces a net present value of $197,850 given a 9%
weighted cost of capital. The project's internal rate of
return is 6%, which is a reasonable return for a
limited-dividend corporation.
In addition, the project produces 39 units of badly needed housing for the low- and moderate-income residents. The majority of the units are 2- and 3-bedroom apartments, appropriate to the demand for multi-family units. Furthermore, the project provides a few amenities not common in this part of Boston: a community center on the 1st floor and a landscaped sitting area on the abutting parcel. A "positive externality" is also produced: major street and sidewalk improvements financed through the use of Community Development Block Grants.

General Management of the Project

The validity of the previous analysis depends, of course, on the accuracy of the information made available to the evaluator and that planned activities do indeed take place. The efficiency and effectiveness ratings are based on the Oxford Street housing project being developed for the quoted construction costs, that the stated mortgage and other funds sources are retained, that the project is operational (occupied and generating income) within one year, and the syndication payments are of the magnitude estimated.

The CEDEC project managers should be commended for bringing the project to this point (given the nature of the real estate industry and the uncertainty involved when dealing with governmental agencies), and in particular for
leveraging the various sources of funds and in-kind contributions to "make it go." However, management of this project was deficient in several respects. Generally poor coordination and inexperience are probably responsible for the extraordinarily prolonged development process (although this project has "been in the works" for five years, final contracts have yet to be signed and construction commenced). More importantly, however, although vague and incomplete cost projections were done in order to secure initial venture capital, a systematic and detailed analysis of financial and nonfinancial aspects of the project was never conducted. For example, commonplace financial ratios such as net present value, internal rate of return, and capitalization rates were never calculated. (Note that the calculations found in this thesis are solely the work of the author, not the CEDC project manager.). Performance of those tasks should be required, and indicative of a businesslike attitude, regardless of the organization's profit or nonprofit nature.
Project Description

CEDC purchased an 11-story office building in 1979, located at 31 Beach Street (hence the project name), in the heart of the Chinatown commercial district. Both Beach Street and Harrison Avenue are major pedestrian and vehicular thoroughfares and are considered major commercial arteries of the Chinese community. The Shawmut Bank of Boston, a well-recognized landmark of the community, occupies the groundfloor of the building. As such, the building is sometimes referred to by community residents as the Shawmut Bank Building.

The building was constructed between 1915 and 1920 of concrete and steel structure with brick facade. It occupies a total land area of 7,200 square feet. The usable floor area of the eleven floors and a usable basement totals approximately 63,000 square feet.

The purpose of the investment was three-fold:

1. Primarily, the asset was purchased to provide home offices for the CEDC Community Services Division (now an autonomous unit). The building was ideal for the housing of this division because of its central location upon which the success of a service program depends.

2. The purpose of the property would enable CEDC to establish a significant equity base in preparation for future development activities which would require CEDC to
show substantial net worth. This was particularly important in the near-term housing development activities which the CEDC was planning to undertake on this and/or on other sites.

3. The building appeared to be well-suited for housing conversion. Preliminary investigation indicated the possibility of putting 44 housing units into the building.

Evaluation

Effectiveness evaluation of this project is much simpler than the previous one, because goal attainment was either complete or nonexistent. Two of the goals were achieved completely, whereas the housing goal was never seriously pursued.

The space needs of the CEDC Community Service Division and its programs were fulfilled, following the purchase and renovation of 31 Beach Street. The location of the building is ideal for the successful operation of direct service programs since it is easily accessible by community residents. As mentioned earlier, the building is situated in the commercial core of Chinatown where residents work, shop, and socialize. The staff envisions that the division and its programs will serve as a focal point of community activities in the future. The locational advantage will certainly enhance maximal usage of the facilities.

Purchase of the building added significantly to CEDC's net worth, indirectly furthering community development activities by demonstrating credibility and financial
strength in preparation for future commercial and housing development projects. As an illustration of the importance of having an adequate equity base, the Federal Housing Administration (FHA) requires housing developers, such as the CEDC, to show 10-15% of a project's total cost as a requisite of granting an FHA guaranteed mortgage. This is to insure that CEDC will have the financial power to complete the project once approved by FHA. Ownership of 31 Beach Street enabled CEDC to obtain an FHA commitment for insurance on its Oxford Street project (In addition, with regard to future business development, the CEDC will need an established equity base to collateralize debt financing).

For reasons that did not become evident in the examination of CEDC records, 31 Beach Street was never converted into housing (although the building was well-proportioned for such a use and no changes in the shell or facade would have been required to rehabilitate the structure). Instead, CEDC has retained the building for light-industrial purposes. All eleven floors are occupied and generating sufficient rents to cover debt service; the Shawmut Bank of Boston occupies the basement and 1st floor, CEDC occupies the 2nd floor, and most of the remainder is occupied by garment manufacturers.

Unfortunately, CEDC financial records with regard to this property were incomplete and sketchy, making a detailed financial analysis impossible.
Operational Management

In the Chinese Economic Development Council daily operational management tasks for all divisions are aggregated to the overall organizational level. Accordingly, all accounting, budgeting, and monitoring originates and is housed in the Accounting Office. Both projects of the Housing and Land Development Division (31 Beach Street and Oxford Street) are treated similarly by the organization, and thusly are treated as one unit in this section.

Financial Accounting

CEDC currently operates on a fund accounting system. The controller is in the process of changing the system to a computerized standard double-entry accounting system. This system will conform to generally accepted accounting principles for accrual accounting. In addition, CEDC has instituted an encumbrance system utilizing purchase orders. CEDC's former use of fund accounting reflects its dependence on funds whose use was restricted (by the grantor) to specific purposes. The system was set up in such a way that the amounts spent for that purpose were separately identified. Each fund is a separate entity, has its own set of accounts, and is self-balancing. Although operating activities were accounted for in an operating fund (as would be expected under fund accounting), most other
activities were categorized into "venture funds." Both the 31 Beach Street and Oxford Street projects were originally granted venture capital from the Office of Economic Development; spending authorization consisted of cash in the fund and limited lines of credit with the Department of the Treasury. CEDC failed to explicitly 'separate out' capital activities from other activities, losing one of the major advantages of fund accounting (that of reporting capital transactions separately from operating transactions).

The decision to change from a fund accounting system to a standard double-entry system (accrual basis), linked with an encumbrance system was a sound one. Utilizing "generally accepted accounting principles" (GAAP) to prepare general-purpose financial statements circumvents the problem of multicolumn statements endemic to fund accounting. (In such multicolumn statements there is no single bottom-line number that inarguably shows the results of operations, in terms similar to a "net income" figure in business statements). Use of the accrual basis assures the matching of revenues and expenses in each period, with the difference appearing as a sort of "net income."

Addition of encumbrance accounting to the overall financial accounting system is a sound method to constantly keep track of mounting future commitments (whether expenses or expenditures). Because CEDC is legally restricted to spend only up to that appropriated by its funding sources
(plus internal retained earnings), the organization must be very careful not to encumber (obligate) funds beyond fixed budget restrictions.

Financial Controls Over Spending

CEDC has designated a budget manager to be responsible for each administrative cost center. (Both 31 Beach Street and Oxford Street come under one budget manager, but are considered separate cost centers.) In addition, CEDC segregates all cost center budget allocations and operates such that no expenditures which clearly relate to another specific cost center or venture are charged to general administration.

Another principle CEDC adheres to is that books for ventures as well as all administrative cost centers are closed, and trial balances and financial statements on all activities are prepared on a monthly basis. Furthermore, CEDC performs (and presents to the Board of Directors) a monthly analysis of actual versus budgeted expenditures, and prepares an explanation of all variances and a year-to-date summary for each quarter.

The installation of the venture fund accounting system and the purchase order system in October of 1980 was designed to increase control over expenditures and proper allocation of income and expenses. All transactions are supposed to be approved by Budget Managers and then checked by the Accounting Office for accuracy before being signed by
the Controller.

CEDC has submitted to the Office of Economic Development (OED) annually, within thirty days of the end of the venture's fiscal year, an updated business plan for each venture. In instances where no significant modifications have occurred, CEDC submitted a statement to that effect.

In toto, these measures seem to provide CEDC management with very good controls over spending. Of particular note are the monthly variance calculations. However, in order for these variances to be effective, they must be taken seriously by both top management and project managers. If regarded as more than a measure to 'comply with the regs,' these variances could significantly affect performance and efficiency with regard to spending levels.

The formal drawdown and encumbrance system, combined with the flow of spending authority (that follows the lines of operating management responsibility) assures a significant amount of control over unplanned or unreasonable expenses. This system could be improved, however, with the installation of "object restrictions." That is, more control should be exercised over spending for certain line items, although the primary focus should remain on programs. As noted by Anthony and Herzlinger (13), there is

(13) Ibid., p. 438.
a fine line between restrictions imposed in order to curb imprudent spending and the restrictions that are unwise because they unduly limit the manager's ability to make decisions on resource allocations. These controls would be easier to define for the 31 Beach Street project because of its stable, income-producing nature. For the Oxford Street property, on the other hand, it is problematic due to the instability and unpredictability of the real property development process.

Information Systems

The information system is centered on a fund accounting (cash) basis, but is being revised to a standard double-entry accounting system (accrual basis). All venture monitoring and accounts payable are now automated.

CEDC has been granted an open-ended unconditional ("no-cost") loan of General Business System software and hardware by Wang Laboratories (the 2200 MVP System), to be used for the storing and processing of all accounting/financial information, payrolls, and personnel records. In addition, the agency leases Wang Word Processors (2 terminals and 1 printer) from Wang Labs at $140 per month.

The small size of the CEDC organization allows the account structure to be simplified so that the program structure and the responsibility structure are identical (at least at the project level of analysis). A program structure is usually designed to meet the needs of planners
and analysts, and emphasizes the full costs of carrying out programs. The responsibility structure, on the other hand, caters to the needs of operating managers (and therefore emphasizes the controllable costs of operating responsibility centers). Top management can summarize information from both structures to resolve conflicts as equitably as possible.

In this case, the Housing and Land Development Division is both a program and a responsibility node. It is treated in the accounts as an expense ("cost") center: a responsibility center for which inputs are measured, but for which there is no monetary measure of output. This, I feel, is a grave error in judgment, particularly in light of the immediate financial pressures confronting the agency as a whole. Instead, the Division should be treated -- both in the accounts and in the eyes of management -- as a profit center.

A profit center is a responsibility center for which both revenues and expenses are measured. It should be noted that a profit center need not earn a profit, or even break even (though it would seem the latter is highly desirable as a prerequisite for continued operation, and a necessity to attain future financial self-sufficiency). The desired relationship between revenues and expenses should be a matter of management policy. The "beauty" of a profit center, however, is that it resembles a business in
The manager is forced to concern himself/herself with both expenses and with furnishing a sufficient quantity and quality of services to produce adequate revenues. Therefore, managerial control over finances in a profit center is more encompassing than in a cost center.

No such comparison of revenues and expenses (fixed and variable, full and controllable) was done for either 31 Beach Street or Oxford Street in the ongoing information accounts. In the case of the Oxford Street project, very vague and incomplete cost projections were done in order to secure initial venture capital; detailed projections of revenues and expenses generated by the project on a multi-year basis was never conducted as part of either a project feasibility analysis or a prospective performance measurement scale.

The same holds true for the 31 Beach Street project. CEDC failed to conduct a detailed financial/nonfinancial multi-year cost-benefit analysis for the project, both initially and to determine ongoing feasibility. Once the project was operating ("throwing off income"), the organization hired a private firm to manage the building in order to devote more staff time to develop new ventures. Although this is perhaps justifiable in light of the small size of the organization and its limited staff, the fact remains that CEDC did not require the building manager to provide detailed financial records of the operation.
Without such information on total and specific revenue and expenses, the organization was unable to (and did not attempt to) determine fixed and variable costs, and thusly controllable and noncontrollable items of expense on a regular basis.

The organization should be commended for the (financially) highly favorable terms on which it obtained its Wang data processing and business hardware; the increased technical capacity is very useful, while the lease payments are almost negligible. It could be a relatively simple task for the Housing and Land Development Division to generate this financial profile of its real estate operations, given the small size of its portfolio and its Wang business hardware. This would make possible an analysis by management of the merits of continuing projects from an economic and social viewpoint, to be weighed against the political implications (such as palatability to those that provide needed resources and other impacts on the organization's constituencies) of proceeding with current operations.

**Budget Preparation**

The budgeting methodology used for these two projects is very complicated, which is probably due to the requirements of CEDC's funding sources. CEDC applies to the Office of Economic Development (OED) for operating funds annually; applications for venture capital are granted if/when
suitable proposals are submitted. Operating costs (primarily personnel) for venture implementation are funded with the annual OED grant, whereas all costs that are formally part of the venture are covered by the special venture grant.

Budgets are developed yearly for both projects, using the previous year's spending levels as a base. Alterations to this case are calculated by taking into account factors such as predicted changes in levels of operation (e.g. continued or new construction, higher occupancy rates and utility requirements), changes in inflation rates, and changes in operating expenses (such as fuel and real estate taxes).

Although this budgeting process may have worked for this organization in the past, CEDC will have to change its "modus operandi" drastically in order to assure its continued existence. After September of 1982 all federal financial support will be cut off, and both operating and venture "revenues" must be completely internally generated. Although one of the most effective budget analysis methods entails starting from a "zero base," this may not be feasible given the short time period between now and September of 1982. Management must "take a long, hard look" at all of the organization's projects, determine which profit centers are (or have the potential to become) self-sufficient, and match these to organizational goals and
priorities. CEDC should also examine the feasibility of "spinning off" certain of the operations (such as the Realty Corporation or individual projects) to capitalize on financial or legal advantages. As noted earlier, such an analysis could be generated relatively easily for the 31 Beach Street project because of its stable income-producing nature. Establishing a budget for Oxford Street would involve crucial "educated guesses" on the part of management with regards to the probability and timing of obtaining financing, meeting construction and occupancy deadlines, and returning a positive net cash flow to sustain operations.

Operational Auditing

CEDC currently undergoes compliance auditing every fiscal year, in order to determine (to the satisfaction of its grantors) whether the financial data is being properly recorded and whether federal regulations on fund usage are being complied with. According to its accountant (the accounting firm of Deloitte, Haskins & Sells), CEDC's financial statements dated from December 1978 through September 1980 presented fairly the financial position of the agency and the results of its operations and changes in fund balances. The firm stated that it "found no material weaknesses in internal accounting control, (14)" nor any

expenditures considered to be questionable costs under CSA guidelines.

However, the organization may wish to consider (at some point in the future when its 'money woes' are less acute) having an operational audit conducted. Such an audit determines whether an entity is managing or utilizing its resources (personnel, property, space, etc.) in an economical and efficient manner, and seeks to identify any inefficiencies or uneconomical practices (including inadequacies in management information systems, administrative procedures, or organizational structure). Operational auditing could serve this organization well if it showed how future decisions can be made in a better way.

Operating Capital Maintenance

Conceptually, CEDC would be said to be adequately maintaining its capital if its net income at least equaled its cost of equity capital, or if its revenues at least equaled its expenses. Examination of the CEDC Realty Corporation financial statements (that holds title to both projects) since its inception in 1979 brings to light the fact that the unit experienced net losses of $5,213 and $19,353 for 1979 and 1980, respectively. It is clear that neither objective (equating revenues and expenses, or equating net income to cost of equity capital) was attained. This "negative operating margin" indicates the questionable state of the Realty Corporation's financial
viability, and/or a reflection of the quality (or deficiency) of asset management services.

In an attempt to monitor capital depletion more carefully, the Accounting Office instituted a formal drawdown system in January of 1981 to reflect a 30-day maximum liability on cash balances. Each drawdown is required to be supported by on-hand invoices, purchase orders, and (based on past experience) a weekly estimate for the remaining weeks of the month. The support is supplied to the Members of the Board of Directors responsible for signing drawdown vouchers.

The addition of this drawdown procedure is an improvement over the present system in that it is an explicit recognition of the need for such monitoring. However, further measures are necessary to bring about improvement in performance, i.e. to "rein in managers" so that expenses are minimized and revenues maximized. Active support on the part of the Board of Directors and senior management will be required to set firm policy in this respect, using expense data as a basis for control. Adherence to the "profit center" approach discussed earlier is important to success in this effort.

Behavioral Considerations

The previous discussions have touched on the technical aspects of a system that assures managerial control over operations. The attitudes of those who use the information
produced by the system and those who are affected by this information is at least as, if not more, important than technical matters.

"A central purpose of any control system is to motivate operating managers to take actions that help accomplish the organization's objectives efficiently and effectively" (15). In an effort to motivate and retain key employees, CEDC instituted in 1980 an Incentive Plan that provides employees compensation for superior levels of performance. The structure of the plan follows the basic principles of a traditional Bonus Plan rather than a Profit-Sharing Plan, due to the difficulties of defining traditional "profits" in a non-profit organization.

Theoretically, this could be a very effective method to overcome the disincentives inherent in the relatively low compensation schedules for top management in the CEDC. However, in practice the Incentive Plan is completely ineffective because it has never been funded. As originally formulated, funds available for the Plan would be those not controlled by any governmental agency, i.e. "unrestricted funds." Tight fiscal conditions have precluded any diversion of funds to the Incentive Plan.

Another inadequacy of CEDC's management system is the

(15) Robert Anthony and Regina Herzlinger, Management Control, p. 448.
lack of a formal and systematic personnel evaluation system. Performance criteria -- particularly ones tied to a compensation or promotion schedule -- are completely nonexistent. Such a system is key towards providing information on the performance of specific managers and projects so that problems in goal setting, strategy formulation, or program implementation can be identified and appropriate steps be taken to resolve these problems.
Performance With Regard to Non-profit Constraints

As noted previously (pp. 7-8), there are certain characteristics of non-profit organizations that affect the managerial control process in those agencies. It would be useful to examine at this time how CEDC's non-profit nature has impacted the effectiveness of its managerial control processes.

1. CEDC has encountered evaluation problems similar to that of other non-profit organizations, due to the absence of a singular measure of performance (similar to the profit measure). Performance measurement and comparisons between costs and benefits are not carried out on a regular, consistent, and objective basis.

2. CEDC is somewhat constrained in its activities because of its complete dependence on a very narrow funding base. Although CEDC is not prevented (for the most part) from engaging in a wide variety of community, land, and business activities, it is prevented from earning a maximum financial return. For instance, both CSA and MHFA placed a 6% rate-of-return ceiling to CEDC from the Oxford Place project. This limited financial return may not be sufficient to fund ongoing operations, due to present financial constraints.

3. CEDC has, until now, been completely public-supported, i.e. CSA has provided 100% of both its operating and venture capital. There has been no formal/strict link between the amount of financial support provided by CSA and the level of service provided to the community (such as housing, technical assistance, or business loans) by CEDC. Therefore, planning future levels of service provision or goods production is difficult, given CEDC's present financial plight and
the uncertainty of future investment by outside parties.

In addition, program managers must often compete among themselves for scarce financial resources. This has, in the past, led to counterproductive in-fighting, information-hoarding, and delays. Furthermore, programs must sometimes be drastically altered and contorted in order to satisfy the demands of those providing resources to the agency.

4. Like many other non-profit organizations, CEDC's Board of Directors have a difficult time arriving at and balancing between courses of action that best serve its impact community and actions consistent with purely businesslike operations.

5. As mentioned previously, CEDC's top managers receive relatively low monetary compensation for their respective positions (that is, in comparison with the salaries that could be expected from an average for-profit concern, given commensurate responsibilities).

6. CEDC has adopted some of the 20th-century accounting and management control concepts, including accrual accounting, budgeting, and variance analysis. The organization does not, however, calculate standard costs, or practice cost accounting, responsibility accounting, or detailed programming.
Organizational Response to Environmental Pressures

**New Organizational Structure**

As noted previously, the new administration is designed to clearly separate competing responsibilities and establish specialization in certain activities. The organization is to be separated into the Development, Accounting, and Operations Divisions. The Development group will remain responsible for all facets of development until such time as income is produced by a venture. The Accounting group will continue to monitor and produce financial statements for both development and operations on a regular basis. The Operations group will assume responsibility for income-producing ventures under an orderly transition procedure developed under the control of the administration.

**Impact on Operating Activities**

Under the old structure, both the 31 Beach Street and Oxford Street projects were the responsibility of the Housing and Land Development Division. Under the proposed reorganization plan, the 31 Beach Street property would come under the purview of the Operations Group because it is a stable, income-producing venture. The Oxford Street project, however, would be placed with the Development Group until such time as the project is financed, constructed, occupied, and producing steady revenues.
**Recommendations**

Many of CEDC's managerial problems stem from the lack of clear direction received by the staff from the Board of Directors. There appears to be a good deal of confusion and ambiguity as to just who (the staff or the Board of Directors) has the authority to make specific policy and programmatic decisions. This issue should be clarified as soon as possible, particularly given CEDC's immediate financial predicament. In addition, the Board should clarify its (or set new) policies regarding the following programmatic and operational guidelines:

1. Revised (and/or streamlined) overall organizational goals, strategies, and priorities.
2. Allocation of staff to management of particular ventures, with a "clear eye to" organizational priorities and timetables.
3. Clear and simple methods to analyze new and ongoing ventures for feasibility, in both financial and other terms.
4. The desired relationship between revenues and expenses, i.e. should the organization strive to "break even," to generate a minimal 6% return on investment, or a market return of at least 10-15%.
5. The possibility of "spinning off" particular segments (for example, the CEDC Realty Corporation or problematic ventures that could adversely affect current "healthy" ventures).
Additional steps should be taken to overcome the structural weaknesses inherent in CEDC's non-profit nature. (I refer to those particular characteristics mentioned on pages 7, 8, 49 and 50 of this thesis.). These include the following:

1. Use of an output vector such as that illustrated on page 23 could be useful for performance and effectiveness measurement purposes. In addition, projects and programs should be examined in terms of conventional financial analysis, producing surrogates for profit measures (such as capitalization rates, internal rates of return, and payback periods). Such measures analyze both efficiency and effectiveness simultaneously. Lastly, performance evaluation criteria must be developed that are clear, fair and consistently applied.

2. As of September 1982, CEDC will no longer be severely constrained by its heavy dependence on CSA funding. Funds will either be internally generated or contributed by outside investors; in either case it appears that the organization will be free to choose what types of activities to engage in and what financial return to seek.

3. CEDC should take active measures to establish a connection between its inputs (budgeted ceilings) and its outputs (service provided). The 'first step' would be to 'put into action' the recommendations posed in #1, i.e. efficiency and effectiveness measures. Second, benefit/cost analyses and alternative return measures should be conducted, preferably under different scenarios. Third, revenue and expenses projections should be calculated on a multi-year basis. Overall, a profit center mentality must prevail. Although some parts of CEDC will be exempt from 'profit-center treatment' (e.g. administration, Executive Director), it should be applied wherever possible and appropriate.
4. There is no easy solution to the problem of balancing public/community needs and the internal/business need of the organization on the part of the Board of Directors.

5. The simplest way to overcome the motivational problem of low monetary compensation of top management is to place as a top priority funding of the Incentive Plan.

6. There are a number of recommendations that are appropriate for CEDC's operational management policies:
   
a. Consider operational auditing in the future;

b. "Separate out" operating and capital transactions in venture accounts;

c. Impose "object restrictions" on specific (controllable) expense items; and

d. Treat all program units as profits centers, with the possible exception of the Executive Director and administrative support.
Bibliography


Total Project Costs

Composition

Equity: 1. Outside (previous to) loan commitment $103,141
2. Included as part of MHFA loan (construction & permanent financing) $566,930

Debt: 11.5% construction loan, 11 months & 11.0% permanent loan, 30 years. $1,837,831

$2,507,902

Salient Facts

1. Purchase price: Land $61,800
   Building $27,000

2. Value of building after rehabilitation (Loan + Equity - Land costs) $2,342,961

3. Depreciable Base $2,342,961

4. Depreciable Life 15 years

5. Method of Depreciation 175% declining balance; switches to straight-line.

6. Estimated Sales Price in Year 15 (net operating income capitalized @ 12%, plus the value of the land) $1,874,908

7. Net Operating Income ("free & clear") $217,573

8. Amount of MHFA (1st) mortgage $1,837,831
   a. Interest rate 11%
   b. Term 40 years
   c. Amortization period 40 years
   d. Constant 11.17187%

*12% discount rate suggested by Robert Leigh, project manager.
# Summary of Estimated Project Costs

## Direct Construction Costs

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction Fees</td>
<td></td>
</tr>
<tr>
<td>Surveys, Permits, etc.</td>
<td>10,024</td>
</tr>
<tr>
<td>Bond Premium</td>
<td>16,000</td>
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<tr>
<td>Architectural Design</td>
<td>94,500</td>
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<tr>
<td>Architectural Inspection</td>
<td>31,500</td>
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<tr>
<td>Clerk of the Works</td>
<td>23,000</td>
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<tr>
<td>Total Fees</td>
<td>175,024</td>
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<tr>
<td>Total Construction Costs</td>
<td>1,930,824</td>
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</table>

## General Development Costs

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</tr>
</thead>
<tbody>
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<td>Construction Loan Interest (11 months, .115 rate)</td>
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<tr>
<td>Real Estate Taxes</td>
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<tr>
<td>Insurance</td>
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<td>MHFA Site Inspection Fee</td>
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<td>MHFA Application Fee</td>
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<td>MHFA Financing Fee (2% loan)</td>
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<td>Legal Fees</td>
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<tr>
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<td>Relocation</td>
<td>--</td>
</tr>
<tr>
<td>Appraisal Fees</td>
<td>2,500</td>
</tr>
<tr>
<td>Credit for Rental Income</td>
<td>--</td>
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<tr>
<td>Total Gen. Dev. Costs</td>
<td>174,595</td>
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</table>

## Total Costs

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount ($)</th>
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<tbody>
<tr>
<td>Developer's Fee</td>
<td>210,542</td>
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<tr>
<td>Land &amp; Building</td>
<td>88,800</td>
</tr>
<tr>
<td>Total Replacement Cost</td>
<td>2,404,761</td>
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<tr>
<td>Equity: Developer's Fee</td>
<td>210,542</td>
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<tr>
<td>Cash</td>
<td>356,388</td>
</tr>
<tr>
<td>Total</td>
<td>566,930</td>
</tr>
<tr>
<td>Loan</td>
<td>1,837,831</td>
</tr>
<tr>
<td>Loan/Replacement Cost Ratio</td>
<td>76.4%</td>
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<tr>
<td>Loan/Total Project Cost Ratio</td>
<td>73.3%</td>
</tr>
<tr>
<td>Construction Cost Per Residential Unit</td>
<td>45,021</td>
</tr>
<tr>
<td>Mortgage Amount Per Residential Unit</td>
<td>47,124</td>
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</table>
**Total Annual Operating Expense Schedule**

<table>
<thead>
<tr>
<th>Item</th>
<th>Expense</th>
<th>Subtotal</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Management Fee</strong></td>
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<td><strong>11,700</strong></td>
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<tr>
<td><strong>Administrative</strong></td>
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<tr>
<td>Payroll Expenses, incl. taxes, etc.</td>
<td>4,719</td>
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<tr>
<td>Legal</td>
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<td>Audit</td>
<td>1,989</td>
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<td>Telephone</td>
<td>507</td>
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<tr>
<td>Office Supplies</td>
<td>312</td>
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<tr>
<td>Other Administrative</td>
<td>78</td>
<td></td>
</tr>
<tr>
<td><strong>Sub-total -- administrative</strong></td>
<td></td>
<td><strong>7,800</strong></td>
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<tr>
<td><strong>Maintenance</strong></td>
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<tr>
<td>Payroll Expenses, incl. taxes, etc.</td>
<td>12,636</td>
<td></td>
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<tr>
<td>Janitorial Materials</td>
<td>1,014</td>
<td></td>
</tr>
<tr>
<td>Landscaping</td>
<td>117</td>
<td></td>
</tr>
<tr>
<td>Decorating (interior only)</td>
<td>1,014</td>
<td></td>
</tr>
<tr>
<td>Repairs (interior &amp; exterior)</td>
<td>4,095</td>
<td></td>
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<tr>
<td>Elevator maintenance</td>
<td>1,599</td>
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<tr>
<td>Garbage, trash &amp; snow removal</td>
<td>234</td>
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<tr>
<td>Exterminating</td>
<td>1,014</td>
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<tr>
<td>Miscellaneous</td>
<td>117</td>
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<td><strong>Sub-total -- maintenance</strong></td>
<td></td>
<td><strong>21,840</strong></td>
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<tr>
<td><strong>Utilities</strong></td>
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<td>Electricity</td>
<td>3,003</td>
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<tr>
<td>Gas</td>
<td>18,993</td>
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<tr>
<td>Water &amp; Sewer</td>
<td>3,003</td>
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<tr>
<td><strong>Sub-total -- utilities</strong></td>
<td></td>
<td><strong>24,999</strong></td>
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<tr>
<td><strong>Utility Allowance (Section 8)</strong></td>
<td></td>
<td><strong>12,144</strong></td>
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<tr>
<td><strong>Insurance</strong></td>
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<td><strong>5,500</strong></td>
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<tr>
<td><strong>Taxes (Real Estate, @12%)</strong></td>
<td></td>
<td><strong>40,746</strong></td>
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<tr>
<td><strong>Replacement Reserve</strong></td>
<td></td>
<td><strong>12,438</strong></td>
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<tr>
<td><strong>Utility Allowance (Section 8 only)</strong></td>
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<td><strong>(12,144)</strong></td>
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<tr>
<td><strong>Total Annual Operating Expenses</strong></td>
<td></td>
<td><strong>125,023</strong></td>
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</tbody>
</table>

*Chapter 121A Tax Agreement with City of Boston*
First Year Project Set-Up

Gross Possible Income (rents) $342,024
- Vacancies (1% of G.P.I.) (3,420)

Effective Rental Income 338,604
+ Other Income (laundry) 3,992

Effective Gross Income (net rents) 342,596
- Operating Expenses (84,277)
- Real Estate Taxes (40,746)

Net Operating Income 217,573
("free & clear")
- Finance Payments (205,320)

Before Tax Cash Flow $ 12,253

Purchasing & Operating Comparables

1. Price/unit: mortgage amount/unit $ 47,124
   : mortgage + equity/unit $ 61,661

2. Total operating expenses/unit $ 2,161

3. Operating expenses/gross revenue 24.60%

4. Real estate taxes/gross revenue 12.00%
   (Chapter 121A Tax Agreement)

5. Average monthly rent/apartment $730.82

6. Actual or project occupancy 99%

Break-Even Analysis

Current or project occupancy 99.00%
Break-even occupancy 95.42%
Margin 3.58%
### Projected Cash Flows ($000s)

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<thead>
<tr>
<th>Year</th>
<th>0</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
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<th>12</th>
<th>13</th>
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<tbody>
<tr>
<td>Free &amp; clear</td>
<td>0</td>
<td>218</td>
<td></td>
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</tr>
<tr>
<td>-Finance charge</td>
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<td>Before tax</td>
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<tr>
<td>cash flow to entire proj:</td>
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<td>CEDC</td>
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<tr>
<td>+ Amortization</td>
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<td>3.16</td>
<td>3.31</td>
<td>3.89</td>
<td>4.32</td>
<td>4.80</td>
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<td>5.91</td>
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<td>8.97</td>
<td>9.96</td>
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<td>13.62</td>
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<td>-Interest</td>
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<tr>
<td>Tax shelter</td>
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</tr>
<tr>
<td>Benefit (a)</td>
<td>30.63</td>
<td>30.43</td>
<td>30.23</td>
<td>30.03</td>
<td>29.82</td>
<td>29.62</td>
<td>29.43</td>
<td>29.26</td>
<td>29.10</td>
<td>28.94</td>
<td>28.78</td>
<td>28.65</td>
<td>28.53</td>
<td>28.42</td>
<td>28.32</td>
<td>28.23</td>
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<td>After tax cash flow</td>
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<td>30.89</td>
<td>30.69</td>
<td>30.49</td>
<td>30.29</td>
<td>30.09</td>
<td>29.89</td>
<td>29.71</td>
<td>29.53</td>
<td>29.36</td>
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<td>28.91</td>
<td>28.77</td>
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<td>Cash inflows:</td>
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<td>Dev.profit</td>
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<td>Synd.proceed</td>
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<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
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</tr>
<tr>
<td>Net after tax cash flow (assumed no sale)</td>
<td>(470)</td>
<td>421</td>
<td>31</td>
<td>30</td>
<td>30</td>
<td>30</td>
<td>30</td>
<td>30</td>
<td>29</td>
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<td>29</td>
<td>29</td>
<td>29</td>
<td>29</td>
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<tr>
<td>Net present value</td>
<td>(b)</td>
<td>197</td>
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<td></td>
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</table>

### Tax Consequences of Foreclosure ($000s)

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<th>Year</th>
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<th>3</th>
<th>4</th>
<th>5</th>
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</thead>
<tbody>
<tr>
<td>Unpaid mte. balance</td>
<td>1838</td>
<td>1835</td>
<td>1831</td>
<td>1827</td>
<td>1823</td>
<td>1819</td>
<td>1815</td>
<td>1812</td>
<td>1808</td>
<td>1804</td>
<td>1799</td>
<td>1793</td>
<td>1784</td>
<td>1775</td>
<td>1766</td>
<td>1755</td>
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<tr>
<td>Net bk. value</td>
<td>2070</td>
<td>1828</td>
<td>1615</td>
<td>1426</td>
<td>1260</td>
<td>1260</td>
<td>1104</td>
<td>947</td>
<td>791</td>
<td>635</td>
<td>479</td>
<td>322</td>
<td>166</td>
<td>10</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Taxable gain on foreclosure</td>
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<td>7348</td>
<td>7348</td>
<td>7348</td>
<td>7348</td>
<td>7348</td>
<td>7348</td>
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<td>7348</td>
<td>7348</td>
<td>7348</td>
<td>7348</td>
<td>7348</td>
</tr>
</tbody>
</table>

(a) 15% corporate tax rate applied; is applicable for corporations earning under $25,000 in profits in 1983. Tax shelter will be used by the other projects in CEDC Realty's portfolio.

(b) 9% discount rate utilized. This "weighted cost of capital" is a combination of the cost of capital of CEDC's sources of funds:

1. 4.11% financed at 0% (operating capital)
2. 22.61% financed at 6% (venture capital)
3. 73.48% financed at 11% (MHFA loan for project)
# Alternative Scenarios For Sale of Project

<table>
<thead>
<tr>
<th></th>
<th>SALE IN YEAR 15</th>
<th>SALE IN YEAR 28</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>LAND</strong></td>
<td>$ 61,800 (a)</td>
<td>$ 61,800 (a)</td>
</tr>
<tr>
<td><strong>BUILDING</strong></td>
<td>$1,813,108 (b)</td>
<td>$1,813,108 (b)</td>
</tr>
<tr>
<td><strong>TOTAL SALE PRICE</strong></td>
<td>$1,874,908</td>
<td>$1,874,908</td>
</tr>
<tr>
<td>Sale price</td>
<td>$1,874,908</td>
<td>$1,874,908</td>
</tr>
<tr>
<td>Net book value</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Gain on sale</td>
<td>$1,874,908</td>
<td>$1,874,908</td>
</tr>
</tbody>
</table>

| No recapture (e) | Gain on sale | $1,874,908 | $1,874,908 |
| Capital gains tax rate (f) | x .28 | x .28 | x .28 |
| Cap. gains tax | $ 524,974 | $ 672,441 | $ 524,974 | $ 559,582 |
| Sale price | $1,874,908 | $1,874,908 |
| Income tax | - 524,974 | - 524,974 |
| Mtge. balance | -1,729,120 | -1,729,120 |
| Net cash from sale (g) | ($379,186) | $14 |
| Present value (g) | ($104,101) | $4 |
| Net present value (NPV) of "no sale" option: | $93,749 (g) | NPV: | $197,854 (g) |
| Internal rate of return: | 6% |

**Notes:**
(a) Original cost
(b) Capitalized income @ 12%
(c) 950% increase
(d) 300% increase
(e) no excess depreciation taken
(f) 28% capital gains tax rate applied
(g) discounted @ 9% weighted cost of capital
Financial Analysis

Equity:
1. Outside (previous to) loan commitment $103,141
2. Included as part of MHFA loan 566,930
Total equity 670,071

Debt: MHFA loan 1,837,831
Total project costs $2,507,902

Simple Return Measures:
- Capitalization rate 8.68%
- Cash-on-cash return 0.04%
- Increase in value 1. Sale price based on capitalized rental income 2,000%
  2. Sale price based on replacement cost 2,600%

Discounted Return Measures:
- Net Present Value @ 9% weighted cost of capital $197,850
- Internal Rate of Return (15-year time horizon) 6.0%
- Payback: 1. Simple payback 8 years
  2. Discounted payback (@9%) 15 years

Proportionate Sources of Total Benefits (at internal rate of return)
- Before Tax Cash Flow 0.26%
- Tax Benefits 29.85%
- Future Value (syndication proceeds & developer's profit) 69.89%
- Total 100.0%

Range of Taxable Income:
- Minimum Income ($182,820)
- Maximum Income ($204,210)