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REPORT TO THE CONGRESS

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Development Of Minority Businesses And Employment In The Hough Area Of Cleveland, Ohio, Under The Special Impact Program B-130515

Office of Economic Opportunity

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

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AUG.17,1971

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-130515

To the President of the Senate and the
Speaker of the House of Representatives

This is our report on development of minority businesses and employment in the Hough area of Cleveland, Ohio, under the Special Impact program of the Office of Economic Opportunity.

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Copies of this report are being sent to the Director, Office of Management and Budget; the Director, Office of Economic Opportunity; and the Administrator, Small Business Administration.

Elmer B. Staats

Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

DEVELOPMENT OF MINORITY BUSINESSES AND EMPLOYMENT IN THE HOUGH AREA OF CLEVELAND, OHIO, UNDER THE SPECIAL IMPACT PROGRAM
Office of Economic Opportunity B-130515

D I G E S T

WHY THE REVIEW WAS MADE

Special Impact programs are designed to have a major impact on unemployment, dependency, and community tensions in urban areas having large concentrations of low-income residents or in rural areas having substantial migration to such urban areas. The purpose of these experimental programs--combining business, community, and manpower development--is to offer the poor an opportunity to become independent and self-supporting through the use of the free enterprise system.

The Special Impact program carried out by the Hough Area Development Corporation in Cleveland, Ohio, was the first of its kind in the Nation to be funded directly by grants from the Office of Economic Opportunity (OEO).

Hough is a 2.3-square-mile area located about 2 miles east of downtown Cleveland. In 1965, 88 percent of Hough's population was black and 15.7 percent of its labor force was unemployed.

OEO funding of the Hough program began in June 1968. Total OEO funding through October 1972 will amount to $5.13 million.

Hough Development is required to provide non-Federal contributions either in cash or in kind of at least 10 percent of total program costs. As of June 30, 1970, non-Federal contributions amounted to about $202,000 or nearly 13 percent of the $1,575,200 of total program costs incurred as of that date.

The General Accounting Office (GAO) sought to determine

--the impact the program has had in Hough,
--its prospects for meeting its goals,
--the actions necessary to attain the goals, and
--how well the program is being managed.

GAO issued an earlier report to the Congress on the Special Impact program in Los Angeles (B-168560, October 7, 1970).

AUG.17,1971

FINDINGS AND CONCLUSIONS

As of February 1971, after more than 2-1/2 years of Federal funding, the Special Impact program had brought few visible benefits to Hough. Considering Hough's deep-seated and long-standing problems of unemployment, poor housing, and high crime rate, however, it would be unrealistic to expect a major social and economic impact in that short a time.

Hough Development leaders have shown a willingness to recognize their errors and have attempted to correct them. GAO believes that they have learned that complex programs require planning not only of what to do but also of how to do it. (See ch. 2.)

If the Special Impact program in Hough is to succeed, it must maintain the support of the Hough community. To this end Hough Development must soon demonstrate that it can produce successful projects which will provide tangible benefits to the community.

The following sections discuss various projects carried out by Hough Development.

Martin Luther King, Jr. Plaza

One of Hough Development's major efforts is a combination shopping center and housing development. The cost of the Martin Luther King, Jr. Plaza is estimated to be about $3 million and is to be financed by funds from the Special Impact grant and a loan from a local bank. In addition, the Small Business Administration (SBA) has agreed to consider financing construction costs for most of the businesses to be located in the shopping center, if they meet SBA's eligibility requirements.

Although construction originally was scheduled to begin in August 1968, only site-grading work had begun as of May 1971. The original starting date was overly optimistic, reflecting a lack of understanding of the complex problems--securing tenants, acquiring land, and obtaining financing--that had to be solved before construction could begin. (See ch. 3.)

McDonald's restaurants

Hough Development purchased a McDonald's restaurant franchise in the Hough area to help lessen community tensions--resulting from a boycott of white-owned McDonald's restaurants in the black community--and to enter into a profitable business. It also purchased another franchise for a restaurant that was under construction on the east side of Hough.

As of February 1971 these restaurants had 78 employees, 26 of whom were Hough residents. Through December 1970 one franchise was making a profit but the other was showing a slight cumulative loss. (See ch. 7.)

Loan assistance

Hough Development also assisted black contractors and businessmen in obtaining needed funds through the Contractor Loan Gurantee program, which has been unsuccessful in achieving certain key objectives, and the Small Business Loan program, which has not had the intended impact.

Six black contractors who had obtained loans from a bank under the loan guarantee program defaulted on their loans and, as a result, were no closer to being able to obtain bank loans without guarantees. In addition, Hough Development had to pay the bank the unpaid balance of $153,700 on the loans totaling $207,500. (See ch. 4.)

The intent of the Small Business Loan program was to provide small loans as seed money to enable firms to obtain larger loans. A Hough official advised GAO, however, that most of the 25 loans to 18 firms were not made for this purpose but were made to meet the borrowers' needs. (See ch. 8.)

Other projects

As of February 1971 Community Products, Incorporated, a rubber parts manufacturing company, had 27 employees, 16 of whom were Hough residents. Handyman's Maintenance Service, Inc., a custodial and maintenance service, had 31 employees, 20 of whom were Hough residents. The latter project had not received OEO approval. Both companies have operated at a loss since they began, but, as a result of recent changes, their financial conditions have improved. (See chs. 5 and 6.)

Hough Development plans to turn over ownership of the businesses started under the Special Impact program to Hough residents once the businesses become profitable. If the various projects reach their full potential, it is conceivable that, until ownership of the businesses is turned over to Hough residents, Hough Development could become a holding company for businesses worth millions of dollars. (See pp. 14, 15, and 17.)

Program management

On three projects, Hough Development used impact funds of about $114,000 in excess of the amounts authorized by OEO. Although OEO subsequently approved the funds' use for two of the projects, the unauthorized use limited OEO's ability to ensure that Special Impact program funds were being used to accomplish program objectives. OEO advised GAO that the entire system of releasing funds for the program had been revised to minimize unapproved expenditures. (See ch. 10.)

RECOMMENDATIONS OR SUGGESTIONS

The Director of OEO, through the Office of Program Development, should:

--Require Hough Development to submit to OEO, within a specific time period, a detailed plan showing how ownership of existing businesses assisted by the Special Impact program will be distributed to Hough residents and/or the planned use for funds derived from ownership retained within Hough Development and, for future projects, require Hough Development to submit such plans as a condition for project approval. (See p. 18.)

--Work with Hough Development and the Federal and local agencies involved to ensure the successful completion of the Martin Luther King, Jr. Plaza, because of the tremendous impact the project can have both on the Hough community and in renewing the confidence in Hough Development. (See p. 23.)

--Carefully monitor, with Hough Development, future operations of Community Products, Incorporated, to ascertain the impact of changes that have been initiated by company management as well as the possible need for further changes. (See p. 32.)

--Evaluate the Handyman project and decide whether to approve it for funding. (See p. 37.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

OEO advised GAO that it agreed generally with the recommendations and informed GAO of the measures to be taken in accordance with the recommendations. (See pp. 18, 23, 32, and 37.)

SBA has emphasized, with respect to the Martin Luther King, Jr. Plaza, that loans cannot be made for speculative purposes and that therefore, before a loan can be committed, a specific, identifiable, eligible small business must agree to use the facilities to be financed by the loan and must assure SBA that it can pay the rent and earn a reasonable profit. (See pp. 23 and 24.)

MATTERS FOR CONSIDERATION BY THE CONGRESS

This report should be of special interest to those congressional committees having oversight responsibilities for federally assisted antipoverty programs, as well as programs concerning minority business enterprises.

Contents

ABBREVIATIONS

GAO	General Accounting Office
OEO	Office of Economic Opportunity
SBA	Small Business Administration

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CHAPTER 1

INTRODUCTION

The Congress authorized the Office of Economic Opportunity, under title I, part D of the Economic Opportunity Act of 1964, as amended (42 U.S.C. 2763), to initiate Special Inpact programs directed to the solution of the critical problems existing in specific poverty areas. These programs are to be of sufficient size and scope to have an appreciable impact in the poverty areas in arresting tendencies toward dependency, chronic unemployment, and rising community tensions.

The Special Impact program carried out by the Hough Area Development Corporation in Cleveland, Ohio, was the first such program to be funded directly by grants from OEO. In reviewing the Hough program, we sought answers to these questions.

--What impact has the program had in the Hough area since it began in July 1968?

--What are the prospects for the program's fulfilling its purpose, and what actions are necessary to help bring this about?

--How well is the program being managed?

Our review generally covered Hough Development's activities from June 1968 to June 1970. Although we basically completed our fieldwork in July 1970, for certain subsequent actions concerning those projects which Hough Development had undertaken as of December 1969, we updated our data through February, March, or May 1971. Our fieldwork after the completion of our detailed review in July 1970 was limited to that necessary to ascertain the status of those projects or problem areas that we had concerned ourselves with during our earlier work.

On October 29, 1970, we requested comments on our draft report from OEO and the Small Business Administration.

OEO's comments, which considered Hough Development's comments, were furnished on February 4, 1971, and are included as appendix I. SBA's comments were furnished on December 4, 1970, and are included as appendix II. We have included in pertinent sections of the report those OEO and SBA comments that we considered appropriate to a clear understanding of the matters discussed.

SPECIAL IMPACT PROGRAMS

Title I, part D, of the Economic Opportunity Act of 1964, as amended, authorized OEO to initiate Special Impact programs to fight poverty in urban areas having large concentrations of low-income residents or in rural areas having substantial migration to such urban areas. These programs--combining business, community, and manpower development--are designed to have a major impact on unemployment, dependency, and community tensions. The Special Impact programs are experimental and offer the poor an opportunity to use the free enterprise system to become independent and self-supporting.

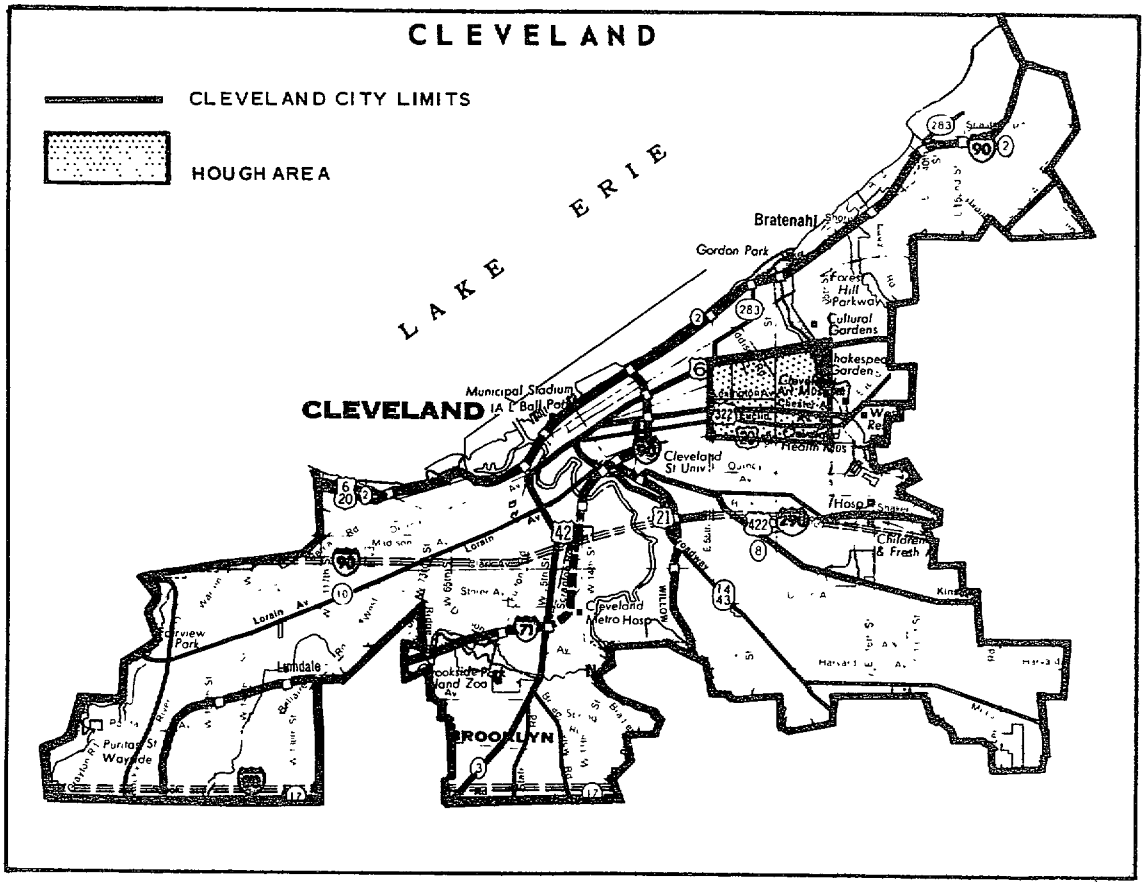
Through June 30, 1970, OEO had awarded grants totaling about $53 million for these purposes to community development corporations representing the residents of eligible poverty areas. In addition, OEO had provided funds of about $52 million designated for Special Impact programs and had delegated administrative responsibility for those programs to the Departments of Labor, Agriculture, and Commerce during fiscal years 1967 through 1969. Beginning in fiscal year 1970, OEO assumed responsibility for administering selected Special Impact programs that had been funded and for all future programs.

This is our second report to the Congress on the Special Impact programs. The first report was entitled "The Special Impact Program in Los Angeles is Not Meeting Goal of Providing Jobs for the Disadvantaged" (B-168560, October 7, 1970).

Hough is a 2.3-square-mile area, predominantly black populated, located about 2 miles east of downtown Cleveland. (See map on p. 7.) In 1965 Hough had a population of 59,000--88 percent of whom were black--compared with

Cleveland's total population of 811,000--34 percent of whom were black. Unemployment in Hough in 1965 averaged 15.7 percent compared with 7.4 percent in Cleveland.

During the past decade many people left Hough to seek a better environment. Vacancies in housing caused rents to decrease, and the poor moved in. The decline in buying power of the residents, rising crime rate, high insurance rates, and other factors caused many businesses to move out of Hough.



Hough Development was conceived in April 1967 when a group of about 20 Hough residents, led by Rev. DeForest Brown, met to discuss ways of interrupting the economic decline of Hough. Deciding that a Hough-based organization was needed to unify and improve efforts toward economic development, the group formed the Hough Area Development Corporation, which was incorporated as a nonprofit organization in the State of Ohio in June 1967.

In an attempt to reverse the economic decline, Hough Development submitted a proposal to OEO in June 1968 for a Special Impact grant to enable Hough Development, through the use of grant funds, to offer leadership, expertise, and risk capital to residents of Hough so that they might

--plan the development of their own community,

--attract and create industries that would train and employ Hough residents,

--attract and own businesses to meet consumer and service needs of area residents, and

--gain entrepreneurial and management skills.

OEO awarded a grant of $1.64 million to Hough Development in June 1968. Additional funding of $1.5 million was approved in June 1969 and made available for program purposes. The grant period ran through June 1970 but was extended through October 1970. In October 1970 OEO approved another grant totaling $1.99 million for the 2-year period ending October 1972.

Hough Development was required to provide non-Federal contributions, either in cash or in kind, of at least 10 percent of total program costs. As of June 30, 1970, non-Federal contributions amounted to about $202,000, or nearly 13 percent of total program costs of $1,575,200 incurred as of that date. At that time the balance of the grant funds remained available for use on Hough Development's projects and on administration of the program.

HOUGH AREA DEVELOPMENT CORPORATION

Hough Development is headed by a 60-member board of trustees, about two thirds of whom are Hough residents. The board is a coalition of many community spokesmen--mostly blacks, a few whites, some poor, and some middle class--including leaders of Hough Community Action Programs involving housing, recreation, education, and welfare. Trustees must reside, have a place of business, or possess a genuine interest, in Hough. The board appointed the Reverend Brown as executive director, with the responsibility for day-to-day operations. As of February 1971 Hough Development had 39 employees, of whom 18 were Hough residents.

Hough Development, in its original proposal for funding in 1968, stated its intent to use the existing neighborhood advisory groups, set up under a local Community Action Program, and a financial advisory council to assist in meeting its objectives. The neighborhood advisory groups allowed residents an opportunity to state their needs and to comment on proposed projects. The financial advisory council, to be made up of a volunteer group of excutives and professionals from the Greater Cleveland area, was to evaluate the economic feasibility of proposed projects. This council, however, was not formed.

HOUGH PROJECTS

Project ideas originate both from the community and from within Hough Development. The excutive director and a 15-member executive committee, appointed by the board of trustees, judge the merit of an idea and make recommendations to the board of trustees. The board decides whether a feasibility study should be made by the Hough Development staff or whether the project idea should be dropped. The results of the feasibility study, along with the executive director's recommendation, are submitted to the board which decides whether to request OEO approval for the project. OEO must approve a project before Federal impact funds can be used for it.

As of March 1971 Hough Development had considered 61 ideas for projects, 36 of which came from community residents. Some ideas were not considered to be feasible or in line with program objectives. Our review covered the seven projects which were in the program as of December 1969. These projects are discussed in detail in chapters 3 through 9. The seven projects are:

--Martin Luther King, Jr. Plaza--a combined shopping center and housing complex.

--Contractor Loan Guarantee program--a project to provide local building contractors with needed operating capital.

--Community Products, Incorporated--a manufacturer of small rubber products used primarily by the automotive industry.

--Handyman's Maintenance Service, Inc.--a company offering custodial and maintenance services to commercial and industrial companies, civic organizations, and homeowners.

--McDonald's restaurants--a project to purchase and operate the franchises of two carryout restaurants.

--Small Business Loan program--a project to provide seed money for obtaining additional funding for new businesses and for improvements and/or expansion of existing businesses.

--Homes for Hough--a housing project on scattered sites in Hough for large, low-income families.

We did not make a detailed review of projects, such as a credit union and a junior achievement program, which were approved or begun after December 1969.

CHAPTER 2

IMPACT ON HOUGH

As of February 1971, after more than 2-1/2 years of Federal funding, the Special Impact program had brought few visible benefits to Hough. Because Hough's problems, such as unemployment, poor housing, and a high crime rate, are deep seated and long standing, it would be unrealistic to expect a major economic and social impact in that short a time.

The Special Impact program in Hough got off to a slow start. When Hough Development began to implement its projects, it became apparent that its grant proposal contained much optimism. Some projects--Contractor Loan Guarantee, Community Products, and Handyman--which had been expected to provide many benefits, provided few. The Martin Luther King, Jr. Plaza had been slow in starting, and the McDonald's restaurants, with good potential for success, did not start until March 1970.

Mistakes were made but Hough Development's leaders showed a willingness to recognize their errors and attempted to correct them. It appears to us that they have learned that complex programs require planning not only of what to do but also of how to do it.

We believe also that the success or failure of the Special Impact program in Hough cannot be measured on a short-term basis. There is much to be done, and only time will tell whether Hough Development, with the assistance of OEO and others, can provide the leadership and know-how necessary to have a major impact on the problems of the Hough community.

ECONOMIC IMPACT

One of Hough Development's major efforts has been to develop the Martin Luther King, Jr. Plaza, which is to include a modern shopping center with 20 stores to meet the shopping needs of residents, provide jobs, and stimulate the Hough economy. Hough Development's original August 1968 date for starting construction was overly optimistic and indicated a lack of understanding by Hough Development of the many complex problems involved. The shopping center, however, has moved closer to reality. As of February 1971, 17 businesses had agreed to lease space and 10 of these had signed leases. In May 1971, site-grading work had begun.

The impact that the shopping center, once constructed, will have on the Hough economy will depend on the success of the tenant businesses. Hough Development, through the use of shopping-center consultants, has attempted to recruit businesses with strong potentials for success. If the businesses within the shopping center are successful, others may move into Hough to compete for the trade. These other businesses would provide more jobs, resulting in more buying power and possible further business growth.

Besides the shopping center, the two McDonald's restaurant franchises have the most promise of providing a lasting economic impact on Hough. As of February 1971 these two restaurants had 78 employees, 26 of whom were Hough residents. Also Hough Development plans to offer shares of stock in these franchises to community residents. At the time the franchises were acquired, total annual sales of $1.4 million were anticipated and profits before taxes were expected to be $175,000. Through December 1970 one franchise was making a profit, but the other was incurring a slight loss.

Hough Development started two other projects, Community Products and Handyman, to provide jobs and ownership opportunities for residents. Although 58 jobs had been provided as of February 1971, generally neither project had shown a profit and Hough Development did not plan to offer ownership of the projects to residents until profits were made. Although some improvements in the management of these projects have been made, further improvements may be needed if the projects are to be successful. As of February 1971:

--Community Products had 27 employees, 16 of whom were Hough residents. The company continually operated at a loss after it began operations in June 1969. The company recognized the need for change and took a number of actions in 1970 to improve its operations.

--Handyman had 31 employees, 20 of whom were Hough residents. The company generally operated at a loss after it began operations in December 1968. Hough Development and the company took a number of actions to improve its operations, however, and its financial records indicated that some of the actions taken had had positive results. The degree to which Handyman will be able to motivate its employees to do a good day's work should have a direct bearing on the ability of Handyman to survive.

Hough Development assisted black contractors and businessmen in obtaining needed funds through two other projects. However, one of these projects--Contractor Loan Guarantee program--has been unsuccessful in achieving certain key objectives and the other project--Small Business Loan program--has not had the intended impact.

As of December 31, 1970, nearly $207,500 had been used to guarantee working-capital loans for six black construction contractors to help them establish credit at a local bank. Although a number of homes had been renovated and jobs may have been salvaged by the project, as of December 31, 1970, all six contractors had defaulted on their loans and therefore were no closer to being able to borrow money on their own which was one of the project's objectives. Hough Development paid off the defaulted loans and in July 1970 decided to phase out this project and to not guarantee any more loans.

As of January 31, 1971, Hough Development, under its Small Business Loan program, had made 25 loans to 18 firms. Two of the firms had gone out of business after receiving the loans and had not repaid the loans. Hough Development had also helped a number of small businessmen in the Hough area by providing advice, guidance, and legal and other technical assistance and by directing them to other organizations, such as SBA, Greater Cleveland Growth Association, Black Economic Union, National Business League, and local banks, for assistance.

SOCIAL IMPACT

When a person gets a job, a house is built, or a business opens, the community benefits not only economically but also socially. In evaluating the total impact of Hough Development's program, therefore, consideration should be given to such social benefits as easing tensions, instilling community pride, and recognizing individual accomplishments. The degree to which Hough Development has met these social and psychological needs of residents cannot be measured readily. We do know that some of Hough Development's efforts, as discussed in the following paragraphs, have been directed to meeting these needs.

Community tensions were eased when Hough Development purchased a McDonald's restaurant franchise in Hough. Tensions had reached a high pitch when four white-owned McDonald's restaurants in Cleveland's black community were shut down for several weeks by a boycott sparked by pickets demanding that the restaurant franchises be sold to blacks. Responding to these demands, an attorney for McDonald's urged Hough Development to purchase one of the restaurant franchises. Hough Development purchased the franchise to help lessen tension and, at the same time, to enter into a profitable business.

Although only scratching the surface of the housing problem, Hough Development has helped nonprofit housing corporations, under its Homes for Hough project, to acquire land on which to build houses. As of February 1971 three housing units were completed and 28 were under construction. Also plans had been made for the shopping center and housing complex to include 26 three-bedroom town houses for low-income families.

Recognizing that there are few places in Hough for residents to shop for their daily needs, Hough Development put a high priority on a shopping center which residents could reach easily. The delay in its construction, however, has caused considerable skepticism among residents as to whether the project ever will be a reality.

Hough Development proposed to decrease tensions and to develop pride in the Hough community by encouraging resident ownership of businesses assisted by the Special Impact program. Hough Development has started several businesses but has not provided ownership opportunities to residents because it prefers to retain ownership in the businesses until they become profitable.

To ensure that ownership opportunities would be made available to residents, OEO included a condition in Hough Development's grant contract requiring that Hough Development submit for OEO approval a plan for disposition of assets Hough Development owned and controlled. Rather than designate a specific date by which the plan was to be submitted, however, OEO stated that the plan was to be submitted at the end of the grant period, which could be extended by additional or supplemental grants. Therefore a plan had not been submitted at the time we completed our fieldwork.

CONTRACTOR'S EVALUATION OF HOUGH PROJECT

Westinghouse Learning Corporation, under a contract with OEO to evaluate a number of Special Impact programs, presented in a report dated July 31, 1970, several conclusions regarding the program administered by Hough Development. Westinghouse concluded, in part, that:

> "The Hough Special Impact project meets legislative and OEO requirements, structurally. The gap between legislative expectation and project consequences is chiefly a matter of unreal expectations, given program design and the level of funding.
>
> "HADC [Hough Area Development Corporation] has been slow in getting needed expert assistance on staff and from outside sources. The organization continues to improve its performance in this area as it gains the experience and self-confidence needed to direct the deployment and use of experts without feeling threatened by them. Though a handicap to early productivity, it is not abnormal or without long-term benefits."

*   *   *   *   *

"Private industry has only limited involvement; and the chances of inducing private industry to locate in Hough are remote given the lack of HADC power, will, and resources to provide incentives. HADC is not anxious to have industries which will be controlled from outside the community. It prefers joint ventures with the community in control."

* * * * *

"The value of the process so far is mainly realized in increased self-development capabilities which are essential to self-sustaining community development.

"The HADC approach to economic development--changing the infrastructure of power, control, and ownership from outside to inside the community--is inherently constrained at the outset, with accelerated benefits over time."

CONCLUSIONS

The Special Impact program has not been in existence long enough to have had a major impact on the Hough community. It is too early to judge, with any confidence, whether the program as a whole will achieve its objectives and goals. If the program is to succeed, however, it must maintain the support of the Hough community. Therefore, within the very near future, Hough Development must demonstrate that it has the ability to produce successful projects which will provide tangible benefits to the community.

Hough Development should place a moratorium on initiating additional projects and should direct all of its efforts to those ongoing projects which have the greatest potentials for success. If the various businesses owned by Hough Development realize their growth potentials, it is quite conceivable that, until ownership is turned over to the community, Hough Development could become a holding company for businesses worth millions of dollars.

To ensure that the residents are given an opportunity to participate in program decisions and benefits and to share program responsibility through ownership, OEO should designate a date when Hough Development would be required to submit a plan showing how and when it intends to distribute ownership of its businesses.

We believe that, in developing such a plan, however, consideration should be given to the retention by Hough Development of a portion of the ownership. This would strengthen its financial base through a continuous source of revenues for investment in future projects, and it might provide more assurance that, should OEO decide to not continue funding the Special Impact program in Hough, Hough Development would have sufficient funds to seek successful development of its projects.

For each future project Hough Development should be required to submit a plan of the degree of, and reasons for, community ownership and/or retention of ownership by Hough Development. This plan should be a part of the proposal sent to OEO for approval of a project, so that OEO will be in a position to determine whether the proposed project meets the legislative intent of the program--arresting tendencies toward dependency, chronic unemployment, and rising community tensions in specific proverty areas.

In our draft report to OEO, we proposed that OEO require Hough Development to place a moratorium on the initiation of additional projects so that Hough would direct all of its efforts toward making its ongoing projects successful.

The Deputy Director, OEO, in his letter to us dated February 4, 1971, stated that from June 1970 a moratorium had been imposed on the initiation of additional projects for the reason mentioned by GAO and that efforts of Hough Development were being focused on existing projects.

RECOMMENDATIONS TO THE DIRECTOR, OEO

We recommend that the Director, OEO, through the Office of Program Development, require that Hough Development submit for OEO approval, within a specific period, a detailed plan of how ownership of existing businesses assisted by the Special Impact program will be distributed to Hough residents and/or the planned use for funds derived from ownership retained within Hough Development. We recommend also that, for future projects, the Director, OEO, require Hough Development to submit such plans as a condition for project approval.

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The Deputy Director, OEO, in his letter of February 4, 1971, stated that:

> "The Board of Directors of Hough Development has a Committee on Community Benefits which is addressing the issue of showing how ownership of existing businesses will be distributed to Hough residents. For each project *** there has been a tentative plan and/or discussion on the divestiture scheme. These plans are being submitted to OEO for approval. In addition, the use of funds derived from such divestitures will be used to further the economic objectives of the program. For future projects Hough Development will be required to submit divestiture plans as a condition of approval."

CHAPTER 3

THE MARTIN LUTHER KING, JR. PLAZA

The most ambitious project undertaken by Hough Development and, in our opinion, the most crucial for the success of the program, is a combination shopping center and housing complex to be called the Martin Luther King, Jr. Plaza. The plaza is designed to provide space for 20 retail businesses in a covered mall and 26 three-bedroom town houses built on the roof of the mall.

The original August 1968 date for starting construction was overly optimistic and indicated a lack of understanding of the many complex problems involved in such a massive effort, such as obtaining financing, securing tenants, and acquiring land. The delay caused considerable skepticism among residents who had seen many past failures of various programs in Hough and caused at least two prospective tenants who had signed letters of intent to lease store spaces to withdraw from the project.

A major obstacle in getting construction under way has been the time needed by Hough Development to convince black merchants of the opportunities available in the plaza. Another obstacle has been the considerable time needed to comply with the requirements of the Federal and local agencies involved in the project.

SBA, under its local development company program, has applications pending for substantial construction loans to Hough Development for the small businesses to be located in the shopping center. Under this program, which is authorized by section 502 of the Small Business Investment Act of 1958 (15 U.S.C. 696), SBA can approve the loans only after the qualified applicants have stated their intent to lease store space. In addition, SBA requires that, before it releases funds to Hough Development, formal leases must be signed by the applicants.

As of February 1971 SBA had agreed to consider financing construction costs through Hough Development for 17 of the 20 businesses to be located in the shopping center if they met SBA's requirements for eligibility. Hough

Development planned to finance the construction costs of the remaining three businesses with impact funds--one (a bank) because it did not qualify for SBA assistance and the other two because Hough Development was having difficulty in securing letters of intent from prospective tenants and did not want to further delay starting construction.

As of June 1970 the 17 businesses had signed letters of intent to lease space but three withdrew their letters of intent, two indicating that they were withdrawing from the project because of the delay in getting construction under way. As of February 1971, however, Hough Development had letters of intent from prospective tenants for 16 of the 17 businesses and from the bank which had agreed to lease space in the shopping center. The major obstacle in obtaining SBA funds as of February 1971 centered on the selection of a tenant acceptable to both Hough Development and SBA for a supermarket which would occupy 40 percent of the floor space in the shopping center.

In March 1971 Hough Development obtained an agreement from a local bank to provide financing for the plaza. Our follow-up of the status of this project in May 1971 showed that site-grading work had been started that month.

OBTAINING FINANCING

Hough Development planned to obtain financing for the plaza from two sources: impact funds and the SBA loan. There was over $1.7 million available from impact funds for the shopping center and the town houses. Hough Development planned to obtain the remaining funds needed for the shopping center through the construction loans from SBA for the 17 businesses. In March 1971 a local bank agreed to loan up to $1.5 million for construction of the plaza.

The estimated cost as of August 1970 to construct the plaza was about $2.8 million, consisting of:

	Estimated cost
Construction:	
Shopping center	$1,725,000
Town houses	675,000
Total construction	2,400,000
Land	174,000
Architects and consultant fees	135,000
Other development costs	58,000
Total estimated cost	$2,767,000

A project official informed us that by February 1971 the estimated costs had increased to about $3 million. The contractors for the construction of the plaza informed SBA and Hough Development that construction costs would escalate about $40,000 for each month construction was delayed.

SECURING TENANTS

Prospective tenants were selected from among 200 to 300 black-owned businesses in the Cleveland area. Selection and screening of tenants was performed by a team consisting of the Hough Development staff and consultants from a shopping-center development firm. As of February 1971, 17 businesses, including the bank, had agreed to lease space in the plaza and 10 of the 17 had signed leases.

The team has had difficulty finding businesses willing to make commitments to lease space. Besides the difficulty of leasing a shopping center prior to its construction, other problems have resulted from the uniqueness of the plaza because it is in a ghetto, involves solely black-owned businesses, and provides housing on the roof of the shopping-center mall.

Another obstacle was SBA's requirement that each tenant financed through an SBA loan sign a 20- to 25-year lease, depending on the financing desired. SBA, however, has agreed to consider alternatives, such as a 10-year lease with a 10-year option available to the tenant.

ACQUIRING LAND

In trying to get title to the land from the city, Hough Development experienced several delays. The city had to agree to sell the land; the city council had to rezone the land, originally designated as residential under an urban renewal plan, to permit its use for retail establishments; and the Department of Housing and Urban Development had to approve the sale price. In January 1971 land was purchased from the city for $123,750. Additional land, to be used for parking, was to be purchased at a later date.

TOWN HOUSES

The 26 three-bedroom town houses will be located around a large courtyard on the roof of the shopping-center mall. Part of the courtyard will be set aside as a play area. The tenants will have private parking and an entrance lobby separate from the shopping center. In addition, each tenant will have a private area of about 200 square feet at the rear of his town house.

The town houses will be leased to the Cleveland Metropolitan Housing Authority which will sublease them to low-income families under a rent supplement program sponsored by the Department of Housing and Urban Development.

IMPACT ON TRAINING AND EMPLOYMENT FOR HOUGH RESIDENTS

Each business which leases space in the shopping center will be required to hire as many Hough residents as possible. Hough Development estimates that the businesses in the shopping center will provide 200 new jobs, including 130 for Hough residents. In addition, 150 temporary jobs will be created during construction, 50 of which will go to Hough residents. As of February 1971 Hough Development planned to apply for a grant from the Economic Development Administration of the Department of Commerce to train shopping-center employees in retailing, inventory control, merchandising, marketing, and advertising.

OWNERSHIP

The plaza will be owned by the Martin Luther King, Jr. Plaza Corporation, which was incorporated in August 1969 as an Ohio nonprofit corporation. During the development and construction of the plaza, the corporation's board of trustees will consist of Hough Development employees. This will enable Hough Development to transfer impact funds to the corporation and to maintain the necessary monitoring function over the funds.

After the plaza opens, the corporation plans to invite residents of Hough to become members of the corporation by buying stock. The corporate code of regulations provides that these members, three fourths of whom must live or work in Hough, elect the board of trustees annually.

RECOMMENDATION TO THE DIRECTOR, OEO

We recommend that the Director, OEO, through the Office of Program Development, work with Hough Development and the Federal and local agencies involved to ensure the successful completion of the Martin Luther King, Jr. Plaza, because of the tremendous impact the project can have both on the Hough community and in renewing confidence in Hough Development.

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The Deputy Director, OEO, stated that he was in total agreement with the need for such an effort. He added that local agencies had been responsive and that the program office had notified SBA of the importance of expediting decisions related to this project.

The Administrator of SBA emphasized that:

> "*** the nature and purpose of the Local Development Company Program is to aid in the economic development of an area by providing loans to assist identifiable small businesses. Section 502 development company loans cannot be made for speculative purposes. Therefore, before loans can be committed, a specific, identifiable, eligible, small business must agree to utilize the

facilities being financed by the loan. However, the small business must provide SBA with a reasonable assurance that it can pay the rent and earn a reasonable profit."

CHAPTER 4

CONTRACTOR LOAN GUARANTEE PROGRAM

Because of the prospects for large-scale housing programs in the Hough area and because of the reluctance of white contractors to work in the area, Hough Development established the Contractor Loan Guarantee program in 1968 to help black contractors get the working capital necessary for performing construction work. By June 1970 Hough Development had guaranteed bank loans totaling nearly $207,500 for six contractors. The loans were made to contractors who were in financial trouble and were used to keep them operating rather than to help them grow.

The loan guarantee program contributed some benefits to the Hough area in that the loans enabled the contractors to continue their home construction and renovation activities--decent housing is a pressing problem in Hough--and continue to employ a number of Hough residents. Of the six contractors, however, five had defaulted on their loans as of June 30, 1970, and one had defaulted on a number of its loans. As a result prospects were dim that one of the major objectives of the program, bank financing on their own, would be accomplished by these contractors. In July 1970, because the program was not succeeding, Hough Development decided to phase it out.

When the program was established, Hough Development planned to guarantee high-risk loans which banks would otherwise be unwilling to make. Hough Development believed that, once the contractors had demonstrated their ability to repay their loans, the banks would be willing to accept the contractors as good credit risks. This financial stability would allow the contractors to grow and at the same time provide needed jobs to Hough residents.

In June 1968 OEO approved the use of $225,000 of the grant funds to establish a revolving fund to be used for guaranteeing loans. Hough Development budgeted and made available $212,000 of that amount for the project. Hough Development was not required to obtain approval from OEO for individual loan guarantees but was required to obtain assurance that the contractor had an adequate accounting system and adequate internal controls to safeguard assets.

The one bank which made all the loans was unwilling to assume any risk, and Hough Development had to guarantee the entire amount of each loan. The following table shows the status of the loans to each contractor as of December 31, 1970.

Contractor	Total amount of loans	Amount repaid	Defaulted
A	$ 20,000	$ 6,000	$ 14,000
B	65,000	-	65,000
C	18,735	3,735	15,000
D	60,184	35,184	25,000
E	37,168	7,168	30,000
F	6,400	1,700	4,700
	$207,487[a]	$53,787	$153,700

[a]$32,000 additional from the revolving fund was used as security for the financing of a duplex house under the Homes for Hough project. Although these funds were not used to meet working-capital needs, they were used to encourage construction in Hough. This loan was repaid in December 1970.

All the loans, except the one to contractor B and the one for financing for the Homes for Hough project, were made to meet working-capital needs. The loan to contractor B was to pay past-due debts as well as to meet working-capital needs.

When the contractors defaulted, $153,700 of impact funds were paid to the bank. A Hough Development official told us that efforts to collect on the defaulted loans had not met with much success.

Hough Development, in its original proposal for funding in June 1968, stated that, before a loan guarantee was approved, a project team would analyze each contractor's financial position. This team was to consist of a consultant or staff member of Hough Development and of consultants from three other organizations working in Hough. Also each contractor was to be evaluated by the Cleveland Contractor Assistance Corporation, a nonprofit corporation that was to provide technical assistance to minority contractors.

Hough Development did not follow its proposed procedures in guaranteeing loans for contractors A and B because neither the project team nor the Cleveland Contractor Assistance Corporation was in operation at the time the loans were made. Hough Development also did not comply with OEO requirements in that it made no attempt to determine whether the contractors had adequate accounting systems.

The guarantees for these two contractors were approved by Hough Development's executive committee on the basis of information provided by the contractors. The proposed procedures were followed, however, for the four other contractors, and Hough Development did get assurance from a certified public accountant that all four had adequate accounting systems.

With regard to another of the program's objectives--providing two thirds of the jobs and training to Hough residents--we were unable to determine how many residents were employed by the contractors as of June 30, 1970. The only data available showed that as of January 1970 four of the contractors were employing 70 men, 17 of whom were Hough residents. According to Hough Development most of these 17 men had been working for the contractors prior to the loan guarantees. Therefore, although Hough Development could not be credited with creating these jobs, its actions under the loan guarantee program may have enabled the contractors to continue operations and employ these persons in construction and renovation activities.

In December 1969 the project team reported to the executive committee that none of the contractors were close to being able to get bank credit on their own, one of the program's objectives. The project team stated that Hough Development had not sought contractors which were entering periods of growth but had guaranteed loans on a first-come-first-served basis to contractors which were in financial trouble. In July 1970 Hough Development decided to phase out the project and to not guarantee any loans after that date.

CHAPTER 5

COMMUNITY PRODUCTS, INCORPORATED

As of June 1970 Community Products, Incorporated, a rubber parts manufacturing company, employed 32 people, 25 of whom were from Hough. The company's heavy operating losses and our analysis of its costs of production indicated a need for significant changes in its operations. The company recognized the need for change and took some actions in 1970 to improve its operations. For example, it negotiated increased prices with some of its customers after we advised management that prices on some products did not cover all of their related costs. The company also recognized that there were problems associated with depending solely on cyclical customers, such as the automobile industry, and it obtained contracts for producing rubber parts for companies which manufacture business machines.

We were unable to evaluate the impact of most of the changes because they had not been fully implemented before the completion of our fieldwork. The company's unaudited financial statements for its first 18 months of operation through December 31, 1970, indicated that its financial situation had improved somewhat during the latter months of the period, although the company was showing an operating loss as of December 31, 1970.

As of June 1970, $198,000 of impact and non-Federal funds had been invested in the company. Because of problems in the way the company's financial statements had been prepared, we were unable to determine with any certainty the actual operating loss sustained as of the time of our follow-up work, although it appeared to be in excess of $300,000.

INITIATION OF PROJECT

One of Hough Development's first priorities was to establish a black-owned and black-operated manufacturing company in Hough. Hough Development believed that the company should enter a field where it could obtain a competitive advantage and decided that the company should manufacture rubber parts, using the injection-molding process.

This process was comparatively new and was supposed to be more efficient than the more conventional process used by most American rubber parts manufacturers.

Hough Development performed an analysis of the rubber-parts-manufacturing field which showed that companies in that field were not reinvesting in capital improvements and that the demand for rubber parts in the automotive industry alone was expected to double by 1972. As a result Community Products was formed late in 1968, with the hope of creating jobs--49 in the first year, 150 within 3 years, and 500 within 5 years--and of giving eventual ownership opportunities to Hough residents.

In its February 1969 proposal to OEO for funding the company, Hough Development estimated that by August 1969 monthly sales would be $70,000. A profit was projected after the first year of operation. The proposal included sales projections of $2 million annually within 3 years and $10 million annually within 5 years. Community Products began operations in June 1969 with $80,000 of impact funds and a $350,000 guaranteed loan from SBA.

ANALYSIS OF PERFORMANCE

Because of the heavy operating losses, we reviewed the costs of production. Adequate cost records were not maintained, and we could not identify the actual cost of production for each part manufactured for comparison with unit sale prices. We did, however, analyze the data available, including cost estimates provided by Community Products, and projected a theoretical break-even point for each of seven parts being produced. We found that even at full production the costs to produce each part would exceed the selling price. In fact for three parts the material and labor costs only--without including overhead and general administrative expenses--would exceed the selling price.

Our estimates were based on the best information available and were conservative. For example, we based our estimates on full production, although full production may be a long way off. Also we made no allowance for normal machine downtime during maintenance or mold changes. Thus the actual unit costs to produce the parts could be significantly higher than those used in our analysis.

In December 1969 we brought the results of our analysis to the attention of Community Products' officials who took the following actions.

--Raised the selling prices of all parts included in our analysis. The prices of only four parts, however, were increased sufficiently to cover the estimated costs.

--Raised the overhead rate to be used in establishing future selling prices.

--Reduced the administrative staff by three persons and thereby reduced administrative costs by $27,500 annually.

--Began, in July 1970, to record the time used in making each part as part of its determination of the cost of producing the parts.

--Hired a chemist part time to determine the most economical rubber compound to be used in each part.

Additional actions were taken during the latter part of 1970 and early in 1971 to further improve the operations. These actions included additional reductions in staff--the number of employees was down to 26 in February 1971 compared with 32 in June 1970--and further price adjustments.

We were unable to evaluate the effect of most of these changes since sufficient time had not elapsed by the end of our fieldwork for the company to have fully implemented the changes. Our analysis of the company's unaudited financial statements, however, indicated that, although the company had not made a profit during the first 18 months of operation, its losses had declined during the latter months of the period.

OWNERSHIP

Community Products was incorporated in October 1968. The articles of incorporation limited ownership to employees of the company or to persons residing in Hough or adjacent areas and to nonprofit organizations working in the area.

No person or organization other than Hough Development may own more than 5 percent of the total subscribed shares.

On the advice of a law firm, Hough Development has decided not to establish a specific plan for distribution of shares until the company has proved profitable. Hough Development, the only shareholder, owns all 500 shares which it purchased with $500 of non-Federal funds.

RECOMMENDATION TO THE DIRECTOR, OEO

Because the continuation of the company, which can provide additional jobs as well as ownership opportunities, is linked to profitablity, we recommend that the Director, OEO, through the Office of Program Development, carefully monitor with Hough Development future operations of Community Products, to ascertain the impact of changes that have been initiated by company management as well as the possible need for further changes.

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The Deputy Director, OEO, stated that a financial monitoring system, developed by a national public accounting firm for the Special Impact program, had been fully implemented and that this system would give the program office, on a quarterly basis, the necessary information to measure change over time.

The Deputy Director added that Hough Development had implemented monthly monitoring reports for all of its subsidiaries and that the reports measure actual performance against projected performance. He stated further that from these reports Hough Development could focus on the problem areas for each company and could assist it through recommendations and corrective measures.

CHAPTER 6

HANDYMAN'S MAINTENANCE SERVICE, INC.

Hough Development funded Handyman's Maintenance Service, Inc., without OEO approval and despite doubt expressed as to the feasibility of the venture by outside consultants in the maintenance field. Although Handyman's total operating costs, from its inception in December 1968 through December 31, 1970, exceeded revenues by about $119,600, the project provided jobs for a number of hard-core unemployed and both Handyman and Hough Development took a number of actions during fiscal year 1970 to improve its operations.

Also OEO approval for the project has been requested several times since February 1969. Although the company had not demonstrated the ability to earn a consistent profit and although OEO had not approved the project as of February 1971, Handyman's financial records indicated that some of the actions taken to improve its operations had had positive results.

In our opinion some of the factors contributing to Handyman's operating loss have been (1) the inability to motivate employees who were previously members of the hard-core unemployed to give a good day's work, (2) the lack of adequate day-to-day supervision, and (3) the high administrative costs incurred in relation to size of staff and volume of business. Other possible factors include difficulty in gaining customer confidence and community acceptance of a service business that uses the previously hard-core unemployed.

Handyman, which was formed in December 1968, was designed to make hard-core unemployed persons productive members of society by training them to perform minor maintenance tasks, including plumbing, plastering, carpentry, custodial duties, landscaping, and gardening. Handyman was intended to give these persons not only jobs but also, eventually, ownership of the company.

Since success of this project is linked largely with the quality of the work performed, we believe that, if this project is to succeed, Handyman must provide effective supervision and must stress to each employee the benefits that are available--a decent wage, a steady job, promotion, and ownership of the company--in return for a good day's work.

PROJECT HISTORY

Since February 1969 Hough Development has submitted several proposals to OEO for the use of impact funds for Handyman. Except for approving $22,000 for personnel and administrative costs, however, OEO did not approve the use of impact funds because it believed that there was no evidence that the company could become a viable business or that the expected impact on Hough justified the expenditures.

OEO's main objection was that the administrative budget, which included three executives having combined annual salaries of $32,800, was out of line with the projected impact of the business--$159,000 annual gross income and only 20 employees. During 1969 Hough Development used $110,400 of impact funds--$88,400 without OEO approval--even though it was aware of OEO's opposition. (The use of the funds is further discussed in ch. 10.)

In a letter to Hough Development in January 1970, OEO stated that it would tighten its controls over impact funds if Hough Development continued to fund Handyman. At that time OEO gave Hough Development 3 weeks to submit a plan for making the project profitable. In February 1970 Hough Development replied with a plan which would immediately result in a small profit, primarily by reducing salaries and wages by 25 percent.

Subsequently OEO questioned certain aspects of Hough Development's plan and requested certain clarifications. In February 1971 Hough Development responded with another plan for the operation of Handyman, which was under review by OEO at the time of our follow-up inquiries in March 1971.

HANDYMAN'S OPERATIONS

Although Handyman has done some landscaping and minor maintenance, most of its work has been custodial services. Because of a high turnover, Handyman hired 82 persons, including 46 Hough residents, for full-time jobs during 1969. As of February 1971, 31 persons, including 20 residents, were employed.

In December 1968, 23 employees entered a 13-week, city-operated training course in plumbing, electrical repairs, plastering, carpentry, glazing, custodial duties, and driver safety. They also recived remedial instructions in English, mathematics, spelling, and geography. Only 13 employees completed the course, and all of them had left Handyman by February 1970.

During its early months of operations, Handyman experienced a number of descipline problems with its employees. According to a Hough Development report dated January 1970, many of the employees had been intimidating their supervisors, which resulted in a lack of adequate supervision. In addition, the company had difficulty motivating its employees to work and to take care of the equipment.

In June 1969 Hough Development and the Handyman board of directors decided that changes had to be made. They recognized the need for a tougher policy to obtain better methods of control over the employees and the equipment. Employees were given a choice of replacing lost or stolen equipment, having the cost value of such equipment deducted from their pay, or being dismissed. As a result a number of the employees who had reportedly intimidated their supervisors were dismissed, along with those employees who had failed to meet adequate work standards.

As an economy move Handyman discharged the manager of the landscape division and the four full-time employees of that division. In February 1970 Hough Development reduced the salaries of Handyman's administrative staff by 25 percent, to emphasize that their salaries were dependent upon the company's making a profit. Hough Development told us that they believed that this action would be an incentive for the staff members to provide better management of the project. In addition, the number of Handyman's employees was reduced by 25 percent.

Handyman officials expressed the view that the improved financial situation in 1970, compared with that of 1969, had resulted from such factors as better management of staff, a further reduction in supervisory staff, greater experience in bidding for contracts, and a policy of being more selective in the hiring of new employees.

Handyman's unaudited profit and loss statements, which are summarized below in 13- and 12-month intervals through December 1970, indicate some improvement in the financial condition of the company since it began operations in December 1968.

	December 1968 through December 1969 (note a)	January through December 1970 (note b)
Fee income	$ 83,900	$115,700
Less operating expenses	114,600	94,700
Gross profit or loss(-)	-57,700	21,000
Less administrative and selling expense	48,200	34,700
Net operating profit or loss(-)	-$105,900	$-13,700

[a]Statements audited through October 1969 by a certified public accounting firm.

[b]During March, May, and August 1970, slight profits of $600, $1,500, and $900, respectively, were reported.

OWNERSHIP

The Handyman articles of incorporation limit ownership to employees and to Hough Development. Hough Development owns all the outstanding shares of the corporation, which it purchased with $500 of non-Federal funds. It had planned to turn ownership over to its employees after the first year of operation but had not done so as of March 1971 because Handyman had not been profitable. A specific method of distributing the stock had not been established.

RECOMMENDATION TO THE DIRECTOR, OEO

We recommend that the Director, OEO, through the Office of Program Development, evaluate the Handyman project and decide whether to approve it for funding.

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The Deputy Director, OEO, stated:

"This project is presently being evaluated by the program office. New [income] projections have been developed and are being reviewed. There has been a concerted effort by Hough Development through its Department of Operations and Management to develop and maintain financial records and controls and its Department of Technical/Feasibility and Economic Development to develop new markets for HMS [Handyman's Maintenance Service], Inc."

CHAPTER 7

MCDONALD'S RESTAURANTS

Community tensions reached a high pitch in Cleveland during the summer of 1969 when four white-owned McDonald's restaurants in Cleveland's black community were shut down for several weeks by a boycott sparked by pickets demanding that the restaurant franchises be sold to blacks. Responding to these demands, an attorney for McDonald's urged Hough Development to purchase one of the restaurant franchises.

Hough Development, in a memorandum to OEO in November 1969, stated that it took this opportunity to help lessen community tensions and, at the same time, to enter into a profitable business which would provide jobs--50, including 13 to Hough residents, as of February 1971--and would provide ownership opportunities to residents. At the same time it purchased another franchise for a McDonald's restaurant that was under construction on the east side of Hough, which provided 28 jobs, including 13 to Hough residents, as of February 1971.

PURCHASE PRICES AND PROFIT POTENTIAL

In January 1970 Hough Development purchased the franchise for the established McDonald's restaurant at East 83d Street and Euclid Avenue for $307,000 and the franchise for a new McDonald's restaurant at East 107th Street and Euclid Avenue for about $121,000. Funds for the purchases and the additional working capital came from the following sources.

Source of funds	83d St. restaurant	107th St. restaurant
Impact grant	$ 75,000	$ 37,500
Owner-manager (note a)	25,000	12,500
SBA-guaranteed bank loan	-	100,000
Conventional bank loan	225,000	-
Total	$325,000[b]	$150,000[b]

[a]McDonald's requires that 25 percent of the franchise be owned by the restaurant manager.

[b]Includes $18,000 and $29,000 for inventory and initial working capital, respectively.

Hough Development began operating the 83d Street restaurant in March 1970 and the 107th Street restaurant in April 1970.

Anticipated annual sales were $810,000 for the 83d Street restaurant and $550,000 for the one at 107th Street. Profits, before taxes, were expected to be 13 percent of sales.

As of December 30, 1970, the 83d Street restaurant had gross sales of about $566,000 and a net income of about $27,000 for its first 9 months of operation under Hough Development ownership. The 107th Street restaurant showed gross sales of about $305,000 and a net loss of about $7,000 for its first 8 months of operation. The 107th Street restaurant, however, sustained its loss during the first several months of operation and showed a slight profit during the latter half of 1970. A project official informed us that sales and profits as of December 31, 1970, were below expectations because of such factors as initial problems with youths at the restaurants; pilfering of food; and, with reference to the 107th Street restaurant, the lack of free parking prior to the end of December 1970.

OWNERSHIP

Hough Development established separate corporations to purchase the restaurant franchises and used non-Federal funds to buy 75 percent of the shares in each corporation. As required by McDonald's, the other 25 percent of the shares were sold to the respective restaurant managers. Hough Development plans to transfer its shares to a holding company which will eventually be owned by Hough residents. Because of a condition of sale imposed by McDonald's, however, Hough Development will retain voting control over the two corporations.

Although the exact method of selling shares in the holding company has not been decided, Hough Development officials told us that shares would be sold only to residents and nonprofit organizations, the number of shares sold to any one person or organization would be limited, and the price would be low.

CHAPTER 8

SMALL BUSINESS LOAN PROGRAM

Recognizing the need to keep existing small businesses operating and to encourage others to move into the Hough area, Hough Development established the Small Business Loan program to help small businesses obtain financing. Hough Development planned to make small loans to needy businesses for use as seed money to enable businesses to obtain larger loans.

In May 1969 OEO approved the use of $25,000 for the project and informed Hough Development that loans could be made without OEO's approval. Loans to any one business, however, were limited to a maximum of $2,500.

As of June 1970 five applications had been received, four of which were approved. The first loan--$2,500--made in August 1969 was used by the recipient to obtain a $25,000 loan to purchase a supermarket. In November and December 1969, two loans of $500 and $2,000, respectively, were made to a second firm to enable it to obtain $5,000 from the Black Economic Union to start a restaurant. The $5,000 loan from the Black Economic Union, however, was not made. Both of these firms have gone out of business without making any repayment to Hough Development.

The fourth loan of $2,500 to a dry cleaning company was made in May 1970 and was to be used by the company to purchase equipment and to pay a debt. Although this loan did not meet the program criteria of providing seed money, Hough Development made the loan to assist a business in need.

In March 1971 we were informed by Hough Development officials that, as of January 1971, 15 more businesses had obtained a total of 21 additional loans. The majority of these loans, however, were not provided as seed money, as required under the program, but were made, according to a Hough Development official, to meet the borrowers' needs.

The Deputy Director, OEO, informed us that the size of the program component precluded any major impact on the Hough community but that the program office was going to evaluate the program to determine its effectiveness.

CHAPTER 9

HOMES FOR HOUGH

Because decent housing is one of the basic needs in Hough, Hough Development has helped nonprofit housing corporations, through the Homes for Hough project, to acquire land on which to build houses. Although it only scratched the surface of the housing problem, this project was designed to help develop decent housing for large families with low incomes.

Hough Development set up a revolving fund with $40,000, contributed by a local businessman, to purchase lots scattered throughout Hough and to sell them to nonprofit housing corporations. These corporations would then be able to get bank financing to construct houses for low-income families. Prior to April 1970 the only impact funds used for this project were for the salary costs of Hough Development's administrative staff members for the time spent in obtaining land, planning the project, and coordinating project efforts with nonprofit housing corporations. In April 1970 OEO approved the use of $40,000 in impact funds as additional seed money for this project.

As of February 1971, three houses--one two-family house and two single-family houses--had been completed and construction was more than half completed on 28 town houses. The project was far behind the initial schedule--51 units completed by the summer of 1969--but that schedule was another example of Hough Development's overly optimistic goals. Hough Development did not consider such time-consuming factors as obtaining approval from the various city commissions and committees and getting the city council's approval to purchase land from the city for use in the project.

CHAPTER 10

FINANCIAL MANAGEMENT

As of January 1, 1970, Hough Development had used impact funds on three projects--$88,400 for Handman, $15,000 for Community Products, and $10,200 for a junior-achievement-type business--without OEO's approval. OEO, however, later approved the use of the funds for Community Products and the junior-achievement-type business. The unauthorized use of funds severely limits OEO's ability to analyze proposed projects and to influence any decisions on project implementation to ensure that only those projects which enhance program objectives are implemented.

OEO advised Hough Development that it would establish tighter controls over the use of funds by withdrawing the letter of credit under which Hough Development operates if Hough Development continued to provide financial support to Handyman.

OEO releases funds to Hough Development through a letter of credit at the Cleveland Federal Reserve Bank. At least once a month, Hough Development obtains funds for financing its operations by submitting a payment voucher to a local bank which draws the funds from the Cleveland Federal Reserve Bank and deposits them in Hough Development's account.

Although we believe that Hough Development's financial system is adequate to control the receipt and expenditure of impact funds, we found a number of minor weaknesses in the system. Hough Development officials told us that corrective actions were being taken to eliminate these weaknesses.

Because violations of grant conditions minimize OEO's influence over the Special Impact program, we proposed in our draft report that OEO withdraw the letter of credit under which Hough Development is funded, if, in the future, funds are used on projects without OEO approval, and then release funds on a monthly basis only after Hough Development shows how the funds will be used.

The Deputy Director, OEO, stated:

"The entire system of releasing funds for Special Impact Programs has been completely revised to incorporate these concerns. The system being used is one that releases only those funds to be used for administrative and planning purposes. The venture capital funds are held by OEO until projects are approved by OEO and then funds are released. While there is no guarantee that administrative funds will not be used for projects the quarterly *** reporting system furnishes financial information of a nature that corrective actions can be taken. Additionally, the OEO *** financial expenditure reports submitted by Hough Development monthly are analyzed by the Program Office to ensure that the expenditure of funds is as has been approved."

CHAPTER 11

SCOPE OF REVIEW

To evaluate the program results and efficiency in administering the Special Impact program in Cleveland, we

--reviewed pertinent legislation and OEO policies and procedures concerning the Special Impact program;

--examined records on the various projects administered by Hough Development and funded by OEO Special Impact funds;

--visited the project sites;

--reviewed the results of audits and evaluations of the Special Impact program in Cleveland; and

--interviewed city officials, Hough community leaders, program participants, officials of local poverty agencies, and SBA officials.

Our review generally covered Hough Development's activities from June 1968 to December 1969. Although our fieldwork was basically completed in July 1970, for certain subsequent actions concerning those projects which Hough Development had undertaken as of December 1969, we updated our data through Feburary, March, or May 1971. Our work, after the completion of our detailed review in July 1970, was limited to that necessary to ascertain the status of those projects or problem areas that we had concerned ourselves with during our earlier work.

Our work was performed primarily at the Hough Area Development Corporation, which is responsible for the Special Impact program in Cleveland, and at OEO Headquarters in Washington, D.C.

APPENDIXES

OFFICE OF ECONOMIC
OPPORTUNITY

EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON D.C.

Feb 4 1971

Mr. Henry Eschwege
Associate Director
United States General
  Accounting Office
Washington, D. C. 20548

Dear Mr. Eschwege:

I am pleased to enclose the comments of the Office of Economic Opportunity on your proposed report on progress toward developing minority businesses and employment in the Hough Area of Cleveland, Ohio, under the Special Impact Program. A copy of the draft report was shared with the Hough Area Development Corporation.

I appreciate having the opportunity of submitting these comments.

Sincerely,

W L Hjornevik

Wesley L. Hjornevik
Deputy Director

Enclosure

Comments of the Office of Economic Opportunity on the draft GAO report of the Comptroller General of the United States entitled "Progress Toward Developing Minority Business and Employment in the Hough Area of Cleveland, Ohio under the Special Impact Program"

The draft GAO report differs slightly from the internal evaluation[1] conducted last summer by OEO. We, therefore, will limit our comments to the specific recommendations made by the GAO draft report.

1. Impact on Hough, A. GAO draft report, p. 15: "That the Director of OEO through the Office of Program Development, direct Hough Development to place a moratorium on the initiating of additional projects in order to direct all its efforts toward making its ongoing projects successful".

OEO Comment:

This has been imposed by the program office since June 1970, for the exact purpose mentioned by GAO. Present efforts of Hough Development are focused on projects in place.

B. GAO draft report, p.15: " . . . we recommend that the Director require that Hough Development submit for OEO approval within a specific period of time a detailed plan showing how ownership of existing businesses assisted by the Special Impact Program will be distributed to Hough residents and/or the planned use for funds derived from ownership retained with Hough Development. We also recommend that, for future projects, Hough Development

[1]GAO note: OEO was advised of GAO's preliminary findings during OEO's evaluation.

should be required to submit such plans as a condition for approval".

OEO Comment:

The Board of Directors of Hough Development has a Committee on Community Benefits which is addressing the issue of showing how ownership of existing businesses will be distributed to Hough residents. For each project in place there has been a tentative plan and/or discussion on the divestiture scheme. These plans are being submitted to OEO for approval. In addition, the use of funds derived from such divestitures will be used to further the economic objectives of the program. For future projects Hough Development will be required to submit divestiture plans as a condition of approval.

2. Martin Luther King, Jr. Plaza, GAO draft report, page 21: "Because of the tremendous impact the project can have both on the Hough Community and in renewing confidence in Hough Development, we recommend that the Director of OEO through the Office of Program Development, work with Hough Development and the Federal and local agencies involved to expedite the construction of the Martin Luther King Jr. Plaza".

OEO Comment:

We are in total agreement with the need for such an effort. Local agencies have been responsive. The program office has notified the SBA of the importance of expediting decisions related to this project.

3. Community Products, Inc., GAO draft report, page 30: "Because additional jobs as well as ownership opportunities are linked to profitability, we recommend that the Director of OEO, through the Office of Program Development, and Hough Development carefully monitor future operations of Community Products, Inc. to ascertain the impact of changes that have already been initiated by company management as well as the possible need for further changes".

OEO Comment:

The major steps taken are the full utilization of the Peat, Marwick, Mitchell financial monitoring system which is now fully implemented and will give the program office on a quarterly basis the necessary information to measure change over time.

In addition, Hough Development has implemented monthly monitoring reports for all its subsidiaries. The reports measure actual performance against projected performance.

From these reports Hough can focus into the problem areas for each company and assist through recommendations and corrective measures. These reports will be shared with the program office.

4. Handyman Maintenance Service, Inc., GAO draft report, P. 35: "We recommend that the Director of OEO through the Office of Program Development, evaluate the Handyman project and make a decision whether to approve it for funding and take whatever actions may be necessary to uphold its decision".

OEO Comment:

This project is presently being evaluated by the program office. New projections have been developed and are being reviewed. There has been a concerted effort by Hough Development through its Department of Operations and Management to develop and maintain financial records and controls and its Department of Technical/Feasibility and Economic Development to develop new markets for HMS, Inc.

[See GAO note, p. 54.]

[See GAO note.]

6. Financial Management, GAO draft report, page 44: "Because violations of grant conditions minimize OEO's influence over the program, we recommend that the Director of OEO through the Office of Program Development withdraw the letter of credit under which Hough Development is funded if, in the future, funds are used on projects without OEO approval, and then release funds on a monthly basis only after Hough Development shows how the funds will be used".

OEO Comment:

The entire system of releasing funds for Special Impact Programs has been completely revised to incorporate these concerns. The system being used is one that releases only those funds to be used for administrative and planning purposes. The venture capital funds

GAO note: The deleted comments relate to matters which were discussed in the draft report but omitted from this final report.

are held by OEO until projects are approved by OEO and then funds are released. While there is no guarantee that administrative funds will not be used for projects the quarterly PMM reporting system furnishes financial information of a nature that corrective actions can be taken. Additionally, the OEO CAP 15 financial expenditure reports submitted by Hough Development monthly are analyzed by the Program Office to ensure that the expenditure of funds is as has been approved.

U.S. GOVERNMENT
SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

Dec 4, 1970

Honorable Henry Eschwege
Associate Director
Civil Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Eschwege:

Reference is made to your letter of October 29, 1970, regarding your draft report on developing minority businesses and employment in the Hough area of Cleveland, Ohio. We have reviewed the sections of the report which you called to our attention and found them to be substantially correct with the following exceptions:

[See GAO note.]

Also, it is of importance to emphasize that the nature and purpose of the Local Development Company Program is to aid in the economic development of an area by providing loans to assist identifiable small businesses. Section 502 development company loans cannot be made for speculative purposes. Therefore, before loans can be committed, a specific, identifiable, eligible, small business must agree to utilize the facilities being financed by the loan. However, the small business must provide SBA with a reasonable assurance that it can pay the rent and earn a reasonable profit. We suggest that consideration be given to rewording Chapter 3 so as to take into consideration the nature of the 502 loan program.

If we can be of further assistance to you, please don't hesitate to call on us.

Sincerely,

for Einar Johnson

Hilary Sandoval, Jr.
Administrator

Enclosure

GAO note: The deleted comments pertain to matters which were discussed in the draft report but omitted from this final report.

PRINCIPAL OFFICIALS OF THE OFFICE OF ECONOMIC OPPORTUNITY RESPONSIBLE FOR THE ADMINISTRATION OF THE SPECIAL IMPACT PROGRAM

	Tenure of office	
	From	To
DIRECTOR:		
Frank C. Carlucci	Dec. 1970	Present
Donald Rumsfeld	May 1969	Dec. 1970
Bertrand M. Harding (acting)	Mar. 1968	May 1969
ASSISTANT DIRECTOR FOR COMMUNITY ACTION PROGRAMS (note a):		
Theodore M. Berry	Apr. 1965	Sept. 1969
ASSISTANT DIRECTOR FOR PROGRAM DEVELOPMENT:		
Alfred H. Taylor (acting)	June 1971	Present
Joseph P. Maldonado	Aug. 1970	June 1971
Marvin J. Feldman	Jan. 1970	Aug. 1970
Robert Perrin (acting)	Sept. 1969	Jan. 1970

[a] In September 1969 this position was terminated as an organizational entity and responsibility for the Special Impact program was transferred to the Office of Program Development.

U.S. GAO, Wash., D.C.

Copies of this report are available from the U. S. General Accounting Office, Room 6417, 441 G Street, N W., Washington, D.C., 20548.

Copies are provided without charge to Members of Congress, congressional committee staff members, Government officials, members of the press, college libraries, faculty members and students. The price to the general public is $1.00 a copy. Orders should be accompanied by cash or check.