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REPORT BY THE U.S.

General Accounting Office

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Improvements Needed In Selecting And Processing Urban Development Action Grants

GAO has reservations about the Department of Housing and Urban Development's use of Urban Development Action Grant funds. The purposes of certain grants could not be related to the action grant program's objectives nor the broad descriptive material HUD has given to the Congress concerning the program's purposes and expectations. In addition, little or no documentation-beyond the area/regional level-existed in program files to show the basis for funding decisions, and grant funds were not always released promptly. GAO is making recommendations aimed at remedying the matters discussed in this report.



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Report

GAO
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CEG-79-64
MARCH 30, 1979



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

COMMUNITY AND ECONOMIC
DEVELOPMENT DIVISION

B-171630

The Honorable Patricia Roberts Harris
The Secretary of Housing and
Urban Development

AGC 00022

Dear Mrs. Harris:

review of
We reviewed the Urban Development Action Grant (UDAG) Program, focusing on application review and approval procedures at HUD headquarters for 18 selected grants from the April 6, July 11, and August 2, 1978, funding rounds. The 154 grants awarded on those dates were the first grants awarded under the UDAG program. ~~Our objective was to evaluate the basis for grant approval, rejection, and holdover decisions, considering the program's objectives and criteria for grant approval.~~ We also evaluated the adequacy of documentation on which such decisions were based and delays in finalizing grants and releasing grant funds. The 18 grants reviewed consisted of 6 new metropolitan city applications, 7 metropolitan city applications held over from earlier rounds, and 5 new small city applications.]

nb We have reservations about HUD's use of UDAG funds in certain instances. We believe that 4 of the 18 grants we reviewed were questionable in that (1) 2 were made without any substantial commitment of private resources, (2) 1 was apparently not needed to stimulate private investment, and (3) 1 primarily benefited a private firm. There was little or no documentation--beyond the area/regional office level--to show the basis for the funding decisions made and the disposition of conflicting area/regional comments on the proposed grants. Also, we found that grant funds were not always released promptly.]

We met with the Assistant Secretary for Community Planning and Development on December 12, 1978, to discuss the four grants in question and other aspects of program administration. He said that the four grant awards were within the UDAG program's intent and objectives. The Assistant Secretary commented that while three of the four awards were "marginal," they were approved in the early application rounds and that in view of HUD's experience since and its receipt of better applications, they probably would not be approved today. He disagreed with our conclusion that one of the four grants was not needed to stimulate private investment (grant to Boston, Massachusetts).

We also discussed the four UDAG grants with the city officials responsible for these projects and have included their comments where appropriate.

We realize that the authorizing law and the regulations for the UDAG program allow wide latitude of judgment in approving grants. However, we could not relate the purposes of these four grants to the UDAG program objectives or to the broad description of the program's main purposes and expectations that HUD has given to the Congress. We cannot comment on the extent to which these grants may be indicative of the other 136 grants made through the time of our review.

A detailed discussion of the four projects which we question, our observations on the lack of documentation and delays in finalizing UDAG contracts, and our conclusions and recommendations are set forth in the appendix.

To Secretary HUD should
Briefly, we recommend that you ^{reassess} how UDAG funds are actually being used in light of the matters discussed in the appendix. We recommend that ^{rigorous, well-documented} reviews ^{be} established within HUD to assure that UDAG funds are used in full accord with program objectives. To preclude funding the types of grants discussed in this report, we also recommend that ^{you} define more precisely what constitutes adequate private commitments, stimulation of new or increased private investment, and benefits to the community. We recommend further that ^{you} direct that (1) files on all UDAG grants include sufficient documentation to justify and explain decisions made regarding funding approvals and disapprovals, including how adverse and conflicting HUD area and regional office evaluations of grant proposals were disposed, and (2) grant funds be released promptly.

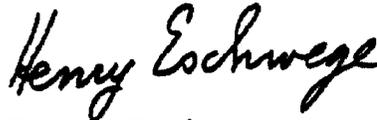
Please advise us of any actions you take or plan to take concerning the matters discussed in this report. If you wish to discuss these matters in more detail, we will be pleased to meet with you or members of your staff.

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report. We would appreciate receiving copies of these statements.

We are sending copies of this report to the four committees mentioned above; your Inspector General and Assistant Secretary for Community Planning and Development; the Director, Office of Management and Budget; the Chairmen, House Committee on Banking, Currency and Housing and Senate Committee on Banking, Housing and Urban Affairs; and the Chairmen, House and Senate Committees on the Budget.

We appreciate the courtesies and cooperation extended to our representatives during our review.

Sincerely yours,



Henry Eschwege
Director

REVIEW OF THE URBAN DEVELOPMENT ACTION GRANT PROGRAMDEPARTMENT OF HOUSING AND URBAN DEVELOPMENTBACKGROUND

In October 1977, the Housing and Community Development Act of 1977 (Public Law 95-128) authorized the Urban Development Action Grant (UDAG) program. UDAG is to assist distressed cities and urban counties that need more public assistance and private investment to alleviate physical and economic deterioration. Grants are awarded to revitalize communities with population outmigration or a stagnating or declining tax base and to reclaim neighborhoods having excessive housing abandonment or deterioration.

Under the program, eligible cities submit grant applications on specific proposals to the appropriate HUD area office. The area office--after determining that the application is complete--prepares comments on the applicant's capacity to carry out the project and complete it in a timely manner; adequacy of the proposed resources; impact of the proposed project on the community's physical, fiscal, or economic deterioration; and other relevant factors. The area office's comments and recommendations, along with any comments or recommendations of the regional office, are then forwarded to the UDAG office in Washington, D.C.

UDAG's Washington office reviews all applications against established selection criteria, assesses recommendations and comments from the field, conducts negotiations between the applicant and the Department of Housing and Urban Development (HUD), and makes recommendations to the Assistant Secretary for Community Planning and Development. The Assistant Secretary, in turn, makes recommendations to the Secretary on proposals that merit funding.

HUD has stated that UDAG funding permits distressed cities and urban counties to promote urban revitalization and to involve the private sector. The latter point, according to HUD, is particularly important as these funds provide opportunities to leverage private investment in distressed communities and private sector financial participation must be guaranteed before Federal funding is approved.

Funding

The Congress authorized \$1.2 billion to fund the UDAG program--\$400 million annually for a 3-year period ending in fiscal year 1980. Each year, one-fourth, or \$100 million, is earmarked for small cities with populations under 50,000.

As of February 1, 1979, HUD had announced UDAG awards totaling over \$560 million. The award dates and amounts are shown below:

<u>Award date</u>	<u>Number of cities</u>	<u>Number of awards</u>	<u>Amount of UDAG awards</u> (millions)
Metropolitan cities:			
4/6/78	45	50	\$148.7
7/11/78	35	39	112.0
10/5/78	40	43	131.5
1/4/79	<u>30</u>	<u>31</u>	<u>90.0</u>
Total	<u>150</u>	<u>163</u>	<u>\$481.2</u>
Small cities:			
8/2/78	61	65	60.7
2/1/79	<u>37</u>	<u>37</u>	<u>17.1</u>
Total	<u>98</u>	<u>102</u>	<u>\$77.8</u>
Total as of			
2/1/79	<u>248</u>	<u>265</u>	<u>\$559.0</u>

Scope of review

Our review was made at HUD headquarters in Washington, D.C., and was directed to the application review and approval procedures followed at the headquarters level for 18 selected grants from the April 6, July 11, and August 2, 1978, funding rounds. Our objective was to evaluate the basis for grant approval, rejection, and holdover decisions, considering the program's objectives and criteria for grant approval. We also evaluated the adequacy of documentation on which such decisions were based and delays in finalizing project contracts and releasing grant funds. We reviewed available grant files and discussed application review procedures, contract negotiations, and other related matters with headquarters personnel.

UDAG AWARDS MADE WITHOUT
ADEQUATE PRIVATE COMMITMENT

Two of the grants we examined, involving a total of \$1.25 million of UDAG funds, did not involve any strong private financial commitment. Accordingly, we questioned whether these grants were awarded in keeping with HUD criteria and UDAG program objectives. The grants were made to the cities of Binghamton, New York, and Detroit, Michigan.

According to HUD regulations, one criterion for program participation is that no activities will be funded unless a firm commitment of private resources is made to the proposed project. HUD has emphasized repeatedly that Federal funds are intended to act as a stimulus for private investment in distressed areas. HUD has also emphasized the concept of leverage--the ratio of private funds to Federal funds--and has stated in its "Action Grant Information Book" that:

"Ideally, HUD will be looking for projects that generate substantially more private commitments than the Action Grant money requested. However, HUD will take into account the various types of projects in considering the degree of private leverage." (emphasis added)

Binghamton, New York

On April 6, 1978, HUD announced that the City of Binghamton had received an action grant of \$1.1 million which it would use to acquire land and provide construction loan financing to a minority businessman to build a 50,000-square-foot industrial building. An additional \$245,000 in funds from the Department of Commerce's Economic Development Administration (EDA) were to be used for site improvements. This development was to be financed entirely with Federal funds, as shown below.

<u>Activity</u>	<u>Cost</u>	<u>Source of funds</u>
Land acquisition	\$ 261,800	UDAG
Relocation expenses	25,000	UDAG
No interest loan	750,000	UDAG
Administrative costs	30,500	UDAG
Contingencies	<u>31,730</u>	UDAG
Total	<u>\$1,099,030</u>	
Site improvements, street and parking facilities	245,000	EDA
	0	Private
Total	<u>\$1,344,030</u>	

The central office reviewer told us that the private commitment was to consist of the developer's repayment to the City of Binghamton, over a 20-year period, of a no-interest, \$750,000 construction loan. The reviewer noted on the headquarters office review sheet that two issues required further negotiation and determination: (1) whether the private firm could afford a commercial loan or commercial interest rates and (2) whether repaying a UDAG loan could be considered a private commitment. When this grant was presented to the Assistant Secretary for Community Planning and Development, the reviewer commented that further negotiations should have occurred before the grant was approved. The reviewer believed that, with more time, some private funding commitment could have been arranged. However, the grant was approved without requiring such a commitment.

We discussed this grant with the Assistant Secretary, who told us that it was unlikely that this grant--made during the first funding round--would be approved today because of the low ratio of private commitment to Federal funds. However, the Assistant Secretary said that repaying a long-term loan did constitute a private commitment of funds.

We also discussed this grant with the City's Director, Community Development. He said that in his opinion repaying this \$750,000 no-interest loan was a very substantial private commitment. However, he agreed that HUD would probably not approve a grant similar to this one again under the UDAG program.

We disagree with the views of both HUD and the city. HUD has stated in its "Action Grant Information Book" that projects cannot be considered for funding unless the applicant can provide evidence that the private sector will invest in the project. In our opinion, it is questionable whether a private firm repaying a \$750,000 no-interest loan to the City of Binghamton, which received the funds as part of its action grant, meets HUD criteria for financial participation in the UDAG program.

Detroit, Michigan

On July 11, 1978, HUD announced that the City of Detroit had received an action grant of \$155,000, which it would use to assist a minority-owned auto dealership acquire its own facilities and expand to an adjacent foreign auto dealership. The grant award was part of the \$965,000 needed by the auto dealer to change his status from tenant to owner and to expand his operation by acquiring certain adjacent properties and equipment. The remaining \$810,000 was to be obtained through other financial arrangements, including a \$500,000 grant from EDA. Twenty-two additional jobs were to be created in the process.

The overall project recommendation from HUD's area office was: "Project is technically ineligible for Action Grant Funding." In summarizing its position, the area office stated:

"In conclusion, it is the opinion of this office that acquisition of an ongoing business, including property, buildings, and equipment, by the Lessee from the Lessor, does not really meet the requirements of the UDAG regulations and therefore, should not be funded."

Regarding the number of low- and moderate-income jobs to be retained or created, the area office stated:

"The City estimates 22 new jobs. Only 6 of these are expected to be Low-Moderate-Income. Additional employment above the present employment level would, for the most part, depend on sales volume increase, rather than UDAG funding."

The HUD reviewer cited two major advantages of the proposed grant and three major disadvantages. The advantages are that the project would

- retain minority-owned business in the city and assist in expansion and
- retain 78 jobs (20 low- and moderate-income) and create an additional 22 jobs (6 low- and moderate-income).

Disadvantages are the following:

- Private sector commitment is weak. The \$500,000 loan guarantee from EDA was uncertain.
- Market appraisal used as basis for cost estimate was dated 1973. It would hardly be reliable in 1978.
- UDAG is being used as a grant for business development; the grant should be a loan at best.

The comments made by both HUD's headquarters and area office reviewers showed that this project did not offer a unique opportunity for Federal funds to be used to leverage substantial private investments.

The Assistant Secretary told us that this grant would probably be withdrawn because the other funds are not materializing as expected. He said that "hoped for" funding is no longer counted as part of a project's private commitment.

In a later discussion of this grant, an official of the city's Planning Department advised us that our description of the facts was accurate and that the UDAG award for this project presented a unique opportunity for a minority business. He also told us that the \$155,000 grant has been modified and is currently with HUD for approval.

UDAG FUNDS NOT NEEDED TO
STIMULATE NEW OR INCREASED
PRIVATE INVESTMENT

Our review of a grant awarded to Boston, Massachusetts, indicated that the UDAG funds were not needed to stimulate new or increased private investment. The development was, in fact, one to which the city and a private developer were already strongly committed.

Although the UDAG program gives financial assistance to distressed communities, it was designed to do so in a rather unique fashion. Specifically, it was envisioned that the program would seek out opportunities where qualifying communities could use Federal funds to stimulate new, or increased private investment for communitywide benefit. The program does not appear to be intended merely to provide communities with funds that would help them meet obligations to which they are already committed.

Boston, Massachusetts

On April 6, 1978, HUD announced that it had awarded the City of Boston an \$8 million grant to fund an underground parking garage above which a private developer would build a 300,000-square-foot retail complex and a 450- to 500-room hotel. Private investment in the development--identified as Lafayette Place--was \$42.8 million with a corresponding city investment of \$15.5 million for land acquisition, site improvements, and other related costs.

The project files showed that:

- The HUD area office identified this project as one that had been under development since 1975. It was described as the second component of a major redevelopment effort in Boston's downtown business area.
- The HUD area office economist, in commenting on the project's market feasibility, said

"Without UDAG funding this proposal will quite probably be completed as planned * * *. The private commitment and the local commitment to this project is such that the UDAG funding is not absolutely necessary in order for this project to commence. There is no indication that UDAG funding would even accelerate the project * * *."

- The private developer, in a letter dated January 5, 1978, indicated that as far as it was concerned the project was not dependent upon the City of Boston's receiving UDAG funds. Although supportive of the city's request for funds, the developer made clear that it was not considered a condition to the city's obligation to the developer.

In discussing this grant with HUD's headquarters office reviewer, we learned that the primary reason the funds were granted was to relieve the City of Boston's tax burden. The

reviewer told us that if the grant had not been awarded, Boston would have had to raise the necessary funds through a bond issue. Such a decision would have, of course, imposed a further tax burden on city residents.

The Assistant Secretary told us that, in his view, the overriding question was not whether the project could have been started without UDAG funds but whether it could have been started without "public" funds. He said that since public funds were needed, he saw no problem in substituting the UDAG commitment for the city commitment.

The city's Director of Federal Relations said that he was in full agreement with the Assistant Secretary's comments. He stated that without UDAG, the project could not have been completed. He said the city had invested a substantial amount of money and would have needed an additional bond issue to fund the project. He added that there was no guarantee the city council would have approved the additional bond issue, especially since it was going to benefit the downtown business area.

We view the use of UDAG funds in this particular instance as highly questionable. We do not believe it is consistent with the program's stated intent of stimulating new economic development activity.

QUESTIONABLE COMMUNITY
BENEFIT FROM UDAG

We question an award made to Dowagiac, Michigan, in that it benefits primarily a private business rather than the community.

The primary objective of the UDAG program is to assist severely distressed cities and urban counties in revitalizing stagnating economies and reclaiming deteriorated neighborhoods. The program is intended to economically benefit the community and its citizens, rather than specific private companies or entrepreneurs. Although private entities can benefit under the program, such benefits should be incidental and secondary to the community benefit.

Dowagiac, Michigan

On August 2, 1978, HUD announced that the City of Dowagiac, Michigan, would receive a \$35,000 grant to help rebuild a movie theater in the central business district that had been destroyed by a fire. Under the terms of the grant, the City of Dowagiac was to use the Federal funds to acquire the site and enter into a long-term lease (99 years) with the former owner, who was to build a new theater at an estimated cost of \$150,000. The major advantage of this project cited in the grant files was that it would restore the only theater in a 20-mile radius of the city.

It appears to us that this theater could well have been an economically viable activity that could have been financed without Federal grant assistance. However, the grant files contained no indication that any economic analysis had been made of the proposed theater operation. The HUD headquarters office reviewer told us that the theater owner in Dowagiac was unwilling to commit more than \$150,000 to restore his business property. Accordingly, the city of Dowagiac applied for and received \$35,000 in UDAG funds. Essentially, it appears that the theater operation will be subsidized with Federal funds with the theater owner as the primary beneficiary. The community's economic benefit from this grant is somewhat vague and seems to have been of secondary importance.

In our discussion of this project, the Assistant Secretary called it a "marginal" project. Program officials said the project was strongly favored by Dowagiac officials and was approved because of the small amount of funds involved.

The city's Director of Community Development told us that the city is experiencing outmigration and a stagnating tax base. He added that no new businesses have been opened downtown in the last 10 years and the developer on this project was not willing to commit funds to restore this theater without other assistance. He said that approving this project was probably a difficult decision for HUD.

PROJECT FILE DOCUMENTATION DID
NOT SUPPORT HUD GRANT DECISIONS

The documentation currently maintained on the UDAG program is seriously deficient. The 18 project files that we examined did not identify adequately the reasons for funding certain projects or withholding funds from others or how reviewers' concerns and criticisms of the projects were ultimately resolved. Since funding decisions were made at the HUD headquarters office level, the project files at the central office should show clearly the basis for those decisions.

Demand for Federal financial assistance under the UDAG program far exceeds the funds available. The \$400 million which has been made available during each of 3 years (fiscal years 1978, 1979, and 1980) is not large, considering that more than 2,400 communities are eligible to participate in the program. Because of the competition for these grants it is essential that funding decisions be documented properly and made a matter of record to maintain confidence in the program and to withstand public scrutiny.

UDAG files in Washington indicated that HUD's area and regional office reviews of grant applications were fairly thorough in identifying and analyzing the advantages and disadvantages of specific proposals, developing recommendations as to which proposals should or should not be funded, and documenting the basis for their recommendations.

However, UDAG program reviewers in Washington did not document their evaluation of material submitted by the HUD field offices. Although their review sheets included a summary evaluation section, normally only major advantages, disadvantages, and issues for further negotiation (suggested conditions for grant contract) were listed. They did not show whether advantages outweighed disadvantages--thus justifying funding approval--or whether disadvantages outweighed advantages--thus delaying or rejecting funding approval. In addition, program reviewers did not document their recommendations in writing. Instead, they made their recommendations orally to the Assistant Secretary for Community Planning and Development who, along with the Secretary, ultimately decided which proposals warranted funding.

Under this system, little written documentation was available--beyond the area/regional office level--to show why funding decisions were made. A better system is needed that shows clearly the basis for funding decisions and that requires documents justifying funding approvals and disapprovals, showing the disposition of conflicting area or regional office comments, and summarizing how disputed issues were or will be resolved. Such improvements would enable the program to withstand public scrutiny and would expedite the contract formulation process. Under the existing system, contract negotiators spend much time researching project files to ensure that the Government's interests are adequately protected by appropriate contract provisions. Having adequate project file documentation would not only provide HUD with a basis to support its funding decisions, but it would also decrease the time between announcing awards and formalizing grants as discussed below.

Program officials agreed that file documentation could be improved. We were told that central office reviewers have been instructed to prepare a summary statement on the essential reasons why a grant is awarded or not awarded.

DELAYS IN THE RELEASE OF GRANT FUNDS

The first grant applications were received in January 1978. As of October 1978, the program had been in existence for about a year but very few grants had actually been made. This was attributable partly to the program being new and needing several months to get started.

One criterion that HUD has used to select applications is the feasibility of accomplishing the project in a timely manner--generally, 3 or 4 years--and within the total resources, both public and private, that will be provided. We believe this is a valid criterion if visible and immediate benefits to the distressed community are to be realized and if inflationary impacts--including increased construction and financing costs--are to be minimized. The criterion makes it important, however, that HUD act quickly and effectively on UDAG applications.

However, HUD has experienced other problems that have delayed grant awards and may hamper the community's ability to complete projects in a timely manner and within budgeted costs. An analysis of HUD's grant awards through September 30, 1978, showed that of 154 announced awards, only 13 grants had actually been formalized.

<u>Date of announcement</u>	<u>Total number of grants announced</u>	<u>Grant</u>		
		<u>Still to be negotiated by HUD</u>	<u>Signed and forwarded by HUD</u>	<u>Signed and returned by city</u>
Metropolitan cities— Apr. 6, 1978	50	12	25	13
Metropolitan cities— July 11, 1978	39	35	4	0
Small cities— Aug. 2, 1978	<u>65</u>	<u>63</u>	<u>2</u>	<u>0</u>
Total	<u>154</u>	<u>110</u>	<u>31</u>	<u>13</u>

Program delays can be seen even more clearly by analyzing the first metropolitan city grant announcements. In April 1978, HUD announced that 45 cities had been awarded 50 grants totaling nearly \$150 million. The 50 awards were selected from 118 applications submitted on or before January 31, 1978. As of October 12, 1978--more than 6 months after the announcement and 8 months after the applications were filed--only one grant had actually progressed to the point that funds could be drawn down through a letter of credit. If we assume it takes a few months to prepare an application, it may take up to 1 year or more before some successful communities actually receive grant funds. Because of inflationary increases in construction costs, this delay may work against projects, especially those that needed the UDAG funds to get started.

In discussing these matters with program officials, we learned that several factors caused the prolonged delay between grant announcement and award. Some involved problems with the grantees' applications which HUD resolved before formalizing the grants. However, our discussions disclosed also that HUD's program office had been hampered by (1) a poorly trained and inadequate number of administrative staff, (2) an insufficient number of contract negotiators to handle the office's workload, and (3) a cumbersome data system which required extensive contract negotiations and a prolonged contract formulation process. These are matters which HUD could correct.

CONCLUSIONS

We believe that 4 of the 18 UDAG grants we reviewed were questionable in that (1) 2 grants were made without any substantial commitment of private resources, (2) 1 apparently was not needed to stimulate private investment, and (3) 1 primarily benefited a private firm.

We recognize that the law authorizing the UDAG program, and the regulations implementing it, allow for wide latitude of judgment in approving grants. However, we could not relate the purposes of these grants to the UDAG program's stated objectives nor to the broad descriptive material HUD has given the Congress concerning the program's main purposes and expectations. We cannot comment on the extent to which these grants may be indicative of the other 136 UDAG grants made through the time of our review.

Documentation in the grant files was not sufficient to show the basis for funding decisions and the disposition of conflicting area/regional office comments on the merits of the proposed grants. Also, grant funds were not released promptly. Substantial improvements are needed in these areas.

RECOMMENDATIONS

We recommend that the Secretary of HUD reassess the ways UDAG funds are being used in light of the matters discussed in this report. We recommend that appropriate steps be taken to establish rigorous, well-documented HUD reviews to assure that UDAG funds are used in full accord with program objectives. To preclude funding the types of grants discussed above, we recommend that the Secretary define more precisely what constitutes

- adequate private commitments,
- stimulation of new or increased private investment,
and
- benefits to the community.

We recommend further that the Secretary direct that

- files on all UDAG grants include sufficient documentatation to justify and explain decisions made regarding funding approvals and disapprovals, including the disposition of adverse and conflicting HUD area and regional office evaluations of grant proposals, and that
- grant funds be released in a timely manner.

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