



United States  
General Accounting Office  
Washington, D.C. 20548

Office of the General Counsel

B-239907

July 10, 1991

The Honorable Henry J. Nowak  
House of Representatives

Dear Mr. Nowak:

On May 29, 1990, you forwarded to this Office a constituent's request for an opinion about Community Development Block Grant (CDBG) funds used as a matching share of an Economic Development Administration title IX economic adjustment grant. Our analysis of the issues raised by that request is enclosed. It appears to us that HUD's attempt to apply CDBG program rules to Buffalo's title IX grant denies Buffalo's right to use CDBG funds as non-federal matching funds under the title IX program.

We trust this analysis will be helpful to you and to your constituent.

Sincerely yours,

A handwritten signature in dark ink, appearing to read "James F. Hinchman".

James F. Hinchman  
General Counsel

Enclosure

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Analysis of  
Community Development Block Grants  
Matching Share Activity  
in Buffalo, New York

Background

Created by the Housing and Community Development Act of 1974 and administered by the Department of Housing and Urban Development (HUD), the Community Development Block Grants (CDBG) program is a major source of federal financial aid to cities and counties. The broad purpose of the CDBG program is to improve the quality of urban life, particularly for persons of modest financial means, through better housing and enhanced economic opportunity. 42 U.S.C. § 5301(c). The city of Buffalo and surrounding Erie County, New York are entitlement grantees in the CDBG program.<sup>1/</sup> Their CDBG funds may be used for authorized purposes including making subgrants and providing matching funds to be used in connection with other federally sponsored grant programs. The latter use is pursuant to express statutory authority found in 42 U.S.C. § 5305(a)(9) (1988).

The Commerce Department and the Economic Development Administration (EDA) administer a community development grant program aimed at helping businesses. The goal of this program, commonly known as title IX, is to assist in economic adjustment, curtail unemployment and stimulate new commercial growth in areas experiencing long term economic deterioration. 42 U.S.C. §§ 3241-45 (1988).

In 1978, the City of Buffalo received \$21 million in CDBG funds, \$1.2 million of which was for participating with the County CDBG and the Erie County Industrial Development Agency in an industrial lending program to finance plant expansions in the Buffalo area. This CDBG activity was approved to be carried out through the auspices of the Regional Industrial Development Bank, an existing nonprofit instrumentality of the Erie County Industrial Development Agency. The CDBG funds

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<sup>1/</sup> As such, they receive funds directly from HUD rather than through the intermediary of the state. The amount of their annual grants is determined by a formula related to population and income levels.

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were to be used as leverage to attract other federal and private financing for individual loans to Buffalo area businesses. The other federal funding was expected to come from EDA economic adjustment funds (title IX) as well as other EDA program funds and Small Business Administration funds. As required by law, HUD made a detailed review of Buffalo's 1978 Community Development Program, prepared as the city's application for CDBG funds. HUD approved most elements of the Program, including the industrial financing program.<sup>2/</sup> Despite HUD's approval, this CDBG activity never went forward.

In 1979, the Erie County Industrial Development Agency received a title IX implementation grant from EDA to capitalize a revolving loan fund, the Industrial Expansion Revolving Loan Fund, which would make direct loans to and purchase debt instruments of local businesses. New loans and investments were to be made on a continuing basis with the program income (principal repayments and interest). Consistent with the authorizing statute, the title IX loan fund was directed toward four main fields of investment. Intended beneficiaries of the title IX financial assistance were new growth industries, high tech firms, older plants hurt by large pollution control expenses, and companies in "'target' distressed areas of the county." The Erie County Industrial Development Agency created another nonprofit affiliate, the Regional Development Corporation, to administer the revolving loan fund.

EDA's original grant to the Erie County Industrial Development Agency was in the amount of \$7 million. That grant was conditioned on obtaining matching funds from local sources. Because the "'target' distressed area" was for the most part coextensive with the area served by the CDBG grants, the city and the county agreed to provide matching funds in the amount of \$1 million and \$150 thousand respectively.<sup>3/</sup> The funds used as the matching share were the moneys previously approved for the CDBG business loan program.

On March 30, 1979, the HUD Acting Area Manager wrote to the Regional Director of EDA, certifying the availability of the CDBG funds to be used as a matching share of the EDA title IX grant. As best we can reconstruct the facts, HUD apparently

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<sup>2/</sup> The statutory requirement for HUD review and approval has since been lifted. 42 U.S.C. § 5304 (1988).

<sup>3/</sup> Subsequent local share contributions, the last of which was made on February 18, 1985, have brought the total city/county CDBG participation in the loan fund to \$4,750,500.

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did not retroactively amend Buffalo's approved Community Development Program for 1978 at the time it signed the certification letter to EDA. Accordingly, HUD records continue to indicate that a CDBG industrial financing program was actually being carried out in Buffalo. Meanwhile, the city, with HUD's approval, committed the CDBG funds as the matching share of the EDA title IX grant.

The application of the CDBG funds used for matching the title IX grant was specified in agreements between the Regional Development Corporation and the city and county. These agreements were signed on August 30, 1979, well after the HUD certification of fund availability. In consideration of the presumed matching share, the Regional Development Corporation agreed to reserve 40 percent of the revolving loan funds for assistance to businesses in the "'target' distressed area."

For the next 9 years, the Regional Development Corporation, the Erie County Industrial Development Agency, the city and the county acted on the basis of an apparent belief that a valid matching grant had been made pursuant to 42 U.S.C. § 5305(a)(9). Accordingly, these parties treated the revolving loan fund as if it were one legal entity. Over that time, the Regional Development Corporation seems to have complied fully with the terms of its agreements with the city and county. The Regional Development Corporation made 74.4 percent of all revolving fund loans, the principal amount of which was \$25,691,474, to businesses in "'target' distressed areas." Because of the loan fund assistance 11,570 jobs were either created or retained in the county.<sup>4/</sup> Also over that time, the Erie County Industrial Development Agency and the Regional Development Corporation have reported progress and fund status to EDA under the terms of the title IX grant. That reporting includes independent audits conducted annually since 1984 under 31 U.S.C. §§ 7501-07, the Single Audit Act. The local parties did not report separately to HUD or apply CDBG program rules, because they were administering the fund pursuant to the terms of the EDA title IX grant.

In 1988, HUD audited Buffalo's CDBG grants. In the audit, HUD regional officials took issue with the 1979 disposition of the \$1 million Buffalo originally contributed as matching

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<sup>4/</sup> The Regional Development Corporation does not know and cannot reconstruct how many jobs were particularly held by persons of low and moderate income. However, it infers from the demographic patterns of the loan activity and income distribution of city/county residents, that a substantial employment benefit was received by lower income persons.



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funds to the title IX grant. At that time, HUD auditors required action to remedy what they saw as serious programmatic, accounting, and reporting deficiencies, among them "commingling" title IX and CDBG funds.

Additionally HUD took the position that the CDBG program regulations are applicable to the lending activity of the Regional Development Corporation. HUD maintained that recipients of future Regional Development Corporation loans must demonstrate that low and moderate income persons will be employed in at least 51 percent of the jobs created or retained as a result of each loan.<sup>5/</sup> HUD also required separate accounting for all program income attributable to the original CDBG funds used in the grant. At one point, HUD also demanded repayment of the CDBG portion of the fund, because of the Regional Development Corporation's inability to demonstrate compliance with the 51 percent requirement.<sup>6/</sup>

The repayment request was withdrawn when the Regional Development Corporation submitted additional documentation on the questioned loans and proposed to partition the loan fund. The loan fund has since been segregated into three different funds--a title IX fund, a "UDAG reflow fund" (no UDAG issues are in contention at this time) and a CDBG fund. The CDBG fund is further subdivided into city and county accounts. Each fund or account will be restricted in its use and loans made will be in compliance with applicable HUD and EDA program rules, as the case may be. Program income will also be credited and redistributed in new loans on an account-by-account basis.

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5/ In addition, HUD requested that past loans be analyzed to determine whether the 51 percent requirement had been met for each individual loan. The Regional Development Corporation reviewed all prior lending activity and was able to provide information satisfactory to HUD on most of the loans made before 1988. All loans were required to be examined because the Regional Development Corporation could not separately track the CDBG-originated funds.

6/ In a subsequent Inspector General audit, HUD also advised the Regional Development Corporation not to make loans to businesses in those jurisdictions of the county which, though covered by title IX, are not eligible for direct CDBG assistance.

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Analysis

HUD's recent actions with regard to Buffalo are an attempt to impose CDBG program regulations on another federal grant being matched with CDBG-originated funds. While the regulations in question ostensibly do no more than specify levels of performance required to demonstrate achievement of the CDBG statute's principal national program objective, the effect of applying them to the title IX grant in this case forced the partition of the revolving loan fund and, after 10 years of successful title IX program operations, "unmatched" the CDBG funds from the title IX grant. HUD's application of the regulations vitiates the statutory authority to engage in matching, and contradicts the CDBG statute which conditions matching eligibility on whether the CDBG grantee had identified the matched grant as serving a community development need, not on ability to comply with program-specific CDBG regulations.

The Housing and Community Development Act of 1974 expressly permits CDBG grantees to use their CDBG funds to provide a local matching share required by another federal grant program. That authority is found in section 105 of the act which lists all the activities for which CDBG funds may be used. In 1979, when Buffalo made the first match with the EDA title IX grant, subsection (a)(9) of that section allowed:

"payment of the non-Federal share required in connection with a Federal grant-in-aid program undertaken as a part of the Community Development Program." (Emphasis added.)

Pub. L. No. 93-833, § 105(a)(9), 88 Stat. 633, 641, 42 U.S.C. § 5305(a)(9) (Supp. V 1975). The emphasized language provides the only limitation on the eligibility of another federal grant program for CDBG matching funds. The emphasized language of the quoted provision has since been amended.<sup>7/</sup> However, the amendment was technical in nature and not intended to make any substantive change in matching grant eligibility. Thus, for the purposes of our analysis, we will refer to the original language.

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<sup>7/</sup> To reflect changes in the Omnibus Budget Reconciliation Act of 1981 affecting the CDBG application process, including a name change for Community Development Program, the amendment changed the emphasized phrase to read "undertaken as part of activities assisted under this title." Pub. L. No. 97-35, § 309(f)(3), 95 Stat. 357, 396.

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The Community Development Program mentioned in the statute was a component of the local government grantee's annual application for CDBG funds. As envisioned in section 104 of the statute, the Community Development Program was a locally prepared analysis of all housing activities, municipal service upgrades, physical improvements, and economic development projects to be accomplished in the community each year.

The Community Development Program was a comprehensive planning tool that served a CDBG function with respect to the application for CDBG funds, but also went beyond CDBG. Clearly, not all activities included in the Program were expected to be funded by CDBG alone. This is evidenced by the fact that the statute also directed local planners to identify all the financial resources, including other federal, state, local and private funds, that would be available to carry out scheduled development activities. Pub. L. No. 93-833, § 104(a)(2)(B), 88 Stat. 633, 638, 42 U.S.C. § 5304(a)(2)(B) (Supp. V 1975).

The prospective CDBG grantee itself prepared the Community Development Program, and could include in the Program any beneficial federal grant program related to community improvement goals, thereby making such grant eligible for a match with CDBG funds. Thus, the potential matching eligibility was extremely broad. However, HUD was required by statute to review and approve the Community Development Program before releasing any CDBG funds.

Because identification in the approved Community Development Program was the sole criterion for determining the eligibility of other federal programs for CDBG matching funds, the only question we need to answer to determine the validity of the use of CDBG funds to supply a required match is whether Buffalo identified title IX in its 1978 Program or not.<sup>8/</sup>

In 1978, Buffalo's HUD-approved Community Development Program, contained a \$1.2 million item for "industrial financing" to be conducted under the auspices of the Regional Industrial Development Bank, an instrumentality of the Erie County Industrial Development Agency. The 1978 Program first proposed to use the approved CDBG industrial financing amounts

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<sup>8/</sup> Although it is not essential to the issues here, as a general proposition we also observe that title IX grants clearly promote economic development and benefit the community. In addition, we understand that HUD approved title IX as a CDBG matching grant in Erie County, as well as the City of Buffalo, and in over 50 other cities nationwide.

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for direct cash infusions to individual businesses. The Bank, which also served as a clearinghouse for other federal financial assistance to businesses, would then attempt to secure other available federal funds from title IX and other economic adjustment programs of the EDA as well as funds from the Small Business Administration. The complete package of federal assistance would then be used to induce private lenders to provide additional financing for the assisted firms. As Buffalo described it, the program would

"mesh Community Development Block Grant funds with funds made available by the Economic Development Administration under title IX . . . ."

Buffalo 1978 Community Development Program at 191. It is evident from the quoted passage that the city intended to combine CDBG funds with title IX grants to maximize the effectiveness of its industrial expansion efforts, albeit through a CDBG direct assistance program rather than a matching grant to EDA. HUD approved Buffalo's 1978 Community Development Program referencing title IX and later certified the use of the approved industrial financing funds for matching the title IX grant in lieu of the originally planned CDBG direct activity.

As we observed above, the sole criterion for matching eligibility was inclusion in the Community Development Plan. There is no doubt that title IX was mentioned in the 1978 Community Development Plan. HUD approved CDBG funds to be used in conjunction with title IX to promote industrial growth in the Buffalo area. When Buffalo later proposed to change the mechanism by which the CDBG and title IX funds would be "mesh[ed]," HUD was consulted regarding the availability of CDBG funds for matching as opposed to direct CDBG assistance. At that time, the HUD Acting Area Manager certified that CDBG funds previously approved for a CDBG direct program of "industrial financing," were available to supply the local matching share required by the EDA title IX grant. We think the original identification of title IX in the Community Development Plan, and the later certification by HUD of fund availability, fully satisfied the statutory criteria for matching eligibility.

Having determined that title IX was eligible to receive a CDBG matching grant from Buffalo in 1979, we must also ask whether HUD has a statutory basis to take additional actions with respect to the continued operation of the title IX grant. In this case, HUD sought to apply regulations imposing additional CDBG-related terms and conditions on the title IX grant by virtue of its having received a CDBG matching share. The



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particular regulations HUD sought to apply to the title IX grant produced a conflict so profound and intractable that the fund managers were forced to partition the loan fund in order to insulate the larger body of title IX funds from the fundamentally incompatible CDBG regulations. This action essentially "unmatched" a match which Buffalo had made in connection with an eligible federal grant-in-aid pursuant to express statutory authority and with HUD's written certification that the funds were available.

An illustration may be helpful in understanding the nature of the conflict caused by superimposing the CDBG program rules on the title IX grant. HUD sought to apply regulations that specify particular aspects of grantee performance necessary to meet the principal national program objective of CDBG, which is to benefit low and moderate income persons. One such regulation is an "area benefit rule" that, if applicable, prohibits CDBG funds from being expended in neighborhoods where the majority of residents have incomes that exceed the low or moderate level. 24 C.F.R. § 570.208(a)(1) (1990). At the same time, the area served by the title IX economic adjustment grant covers all of metropolitan Buffalo including the more affluent sections. An express function of the EDA title IX loan fund is to assist businesses located in "'target' distressed areas," but the title IX fund also exists to lend to high tech firms, and other specific categories of business borrowers, irrespective of their geographical location within the metropolitan area.<sup>9/</sup> Furthermore, EDA title IX regulations specifically require that the administrator of a title IX revolving loan fund serve as a trustee for all potential borrowers. 15 C.F.R. § 308.5(c)(2) (1991). That fiduciary responsibility extends to borrowers whose businesses, because of their location, would not qualify for similar assistance from a CDBG loan program. Consequently, the Regional Development Corporation cannot fulfill its obligations as a trustee of the revolving loan fund and at the same time comply with the HUD area benefit regulation.

As illustrated above, HUD's attempt to apply CDBG program rules to Buffalo's title IX grant caused an irreconcilable conflict which ultimately necessitated breaking down the

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<sup>9/</sup> In fact, the Regional Development Corporation made nearly 75 percent of all its loans on the basis of the borrower's location in a "'target' distressed area." However, the Regional Development Corporation also made loans to high tech firms and other qualified borrowers whose businesses were located outside the CDBG boundaries.

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title IX revolving loan fund into three separate loan programs, each run under different rules. This is the antithesis of a matching grant and appears to us to deny Buffalo its statutory right to use the CDBG funds as non-federal matching funds under the EDA title IX program.