

United States General Accounting Office

**GAO**

Report to the Honorable  
Bob Carr, House of Representatives

April 1989

# URBAN ACTION GRANTS

## Lansing, Michigan's Grant Requires Action



**Resources, Community, and  
Economic Development Division**

B-233030

April 11, 1989

The Honorable Bob Carr  
House of Representatives

Dear Mr. Carr:

This report responds to your request for an investigation of an Urban Development Action Grant (UDAG) approved in 1984 for Lansing, Michigan, by the Department of Housing and Urban Development (HUD). To address your request, we reviewed the changes in the scope of the project, including the decrease in the dollar amount of the grant from \$3.3 million to \$889,785; the allegations that the project changed from a high-technology research center to a professional office building; and the reduction in the number of proposed jobs from 600 to 60. We also examined whether HUD's regulations, policies, and procedures allow for such changes. In addition, we determined the current status of the grant. You also asked whether other communities in the United States are in a similar situation regarding UDAG projects.

The grant approved for Lansing, Michigan, was intended to finance the purchase and installation of fixed capital equipment for use in the Hannah Technology and Research Center located in Meridian Township, Ingham County, Michigan. The City of Lansing entered into an agreement with Meridian Township, and the two municipalities agreed to share the expected benefits, including jobs and tax revenues, of the UDAG project. According to the original grant agreement, the Hannah Technology and Research Center was to be managed "with emphasis on leasing laboratory space to small companies specializing in hi-technology research and development." The intent of this project was to attract businesses that could base their research on the new technologies under development at nearby Michigan State University. According to the developer's business development consultant, construction of the two buildings in the project began in November 1984 and, according to the certification of the project architect, was substantially completed on January 20, 1987.

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**Results in Brief**

The changes in the project's scope resulted from separate actions by HUD on two proposed amendments to the original grant agreement. In 1986, HUD officials approved a reduction in the grant amount from \$3.3 million to \$889,785. In 1987, HUD officials approved a modification that deleted the emphasis on leasing laboratory space to high-technology research

a total project budget of about \$13.3 million. Because the UDAG legislation requires that HUD award the least amount of UDAG funds necessary to carry out a project and because HUD officials believed the UDAG funds were no longer needed, HUD officials considered canceling the grant in July 1986. HUD officials believed that the \$10 million in industrial revenue bonds and the \$4 million in developer equity would be sufficient to cover both the construction-related costs and the capital equipment costs of the project.

Ultimately, however, HUD did not cancel the grant. Instead, HUD reduced the grant to \$889,785, the minimum amount needed to protect the tax-exempt status of the industrial revenue bonds, according to Meridian Township officials. According to HUD officials, if the UDAG had been canceled, the interest earned on the industrial revenue bonds used to fund construction costs would have become taxable. According to Meridian Township officials, if the interest earned on the industrial revenue bonds became taxable, Meridian Township's Economic Development Corporation, which originally issued the industrial revenue bonds, might have been liable for damages to the developer because the corporation was obligated in its loan agreement with the developer to protect the bonds' tax-exempt status.

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## Modifications in the Project's Leasing Requirements

In a January 30, 1987, letter to the Mayor of Lansing, the developer requested expanding the focus of the project beyond its original high-technology emphasis to include office space leasing. The developer requested this change after failing to lease space to a large biotechnology research institute. Meridian Township and Lansing officials believed that leasing space in the Hannah Technology and Research Center to a major high-technology tenant such as the institute would attract firms involved in similar research and would create a large number of jobs. The developer had envisioned the institute as the project's primary high-technology tenant and was unsuccessful in finding another high-technology tenant for the project.

In the meantime, the developer had leased office space in the project to a variety of companies not generally considered to be involved in high-technology research. According to the developer, space had been leased to conventional office tenants in order to collect income from the project. Although the developer maintained that the facility could still support high-technology research tenants, he also wanted to be able to lease to conventional office space tenants.

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## Changes Allowed by HUD Regulations, Policies, and Procedures

HUD's regulations, policies, and procedures allow for the types of changes in Lansing's grant and give program personnel broad discretion in administering grants. Specifically, the regulations allow the applicable community to request approval for amendments involving new activities or alterations that will change the scope, location, scale, or beneficiaries of project activities. According to HUD officials, grant amendments are needed because, among other things, economic conditions affecting a project, such as construction costs, are subject to change.

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## Current Status of the Grant

According to HUD officials, as of February 1989, the UDAG funds had not been released to the City of Lansing. According to HUD officials, Lansing officials must submit documentation required by the grant agreement, including the UDAG loan agreement between the city and the developer. In addition, according to these officials, Lansing officials have agreed to submit the remaining documentation after HUD officials establish new deadlines for the developer to purchase the fixed capital equipment specified in the grant agreement. According to a UDAG development officer at HUD, the developer has found a tenant capable of using \$281,087 of fixed capital equipment, which meets UDAG requirements, but the developer still needs to find tenants to use capital equipment purchased with the remaining funds.

In a series of meetings with us in November 1988, officials of HUD, Lansing, and Meridian Township, and representatives of the developer expressed their willingness to implement the revised grant agreement. HUD officials agreed that a considerable amount of time has passed since Lansing's grant was approved and that they should act to implement or terminate the grant. In January 1989, HUD officials told us that they intend to take the following approach to moving the grant process forward. First, HUD officials will set new deadlines for the City of Lansing to submit the remaining required documentation and for the developer to purchase the fixed capital equipment specified in the grant agreement, as requested by Lansing in a January 1989 letter. Second, if Lansing officials submit the required documentation, HUD officials will arrange for the UDAG funds to be released. Third, if either the City of Lansing or the developer does not meet the new deadlines, HUD officials may take action to bring the matter to closure, including exercising their option to terminate the grant. As of February 1989, HUD officials said that they were working to establish deadlines for the City of Lansing to submit the remaining documentation and for the developer to purchase the capital equipment.

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new deadlines, we recommend that HUD take all actions needed to resolve this matter, including termination of the grant, if appropriate.

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Appendix I provides a chronology and detailed discussion of events associated with the grant. In developing the chronology, we interviewed the Mayor of Lansing, Michigan, and other Lansing officials, Meridian Township officials, the developer of the project, Michigan State University officials, and representatives of labor unions involved in the construction of the project. We discussed the details of grant procedures with HUD officials and reviewed HUD's grant files. We analyzed documentation provided to us by those interviewed, including correspondence between all of the concerned parties, the grant application, the grant agreements, and other legal documents.

We discussed the report's contents with responsible agency officials and incorporated their views where appropriate. However, as agreed with your staff, we did not obtain formal agency comments on this report.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will provide copies to the Secretary of HUD and other interested parties and make copies available to others upon request.

Major contributors are listed in appendix II.

Sincerely yours,



J. Dexter Peach  
Assistant Comptroller General



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Lansing officials<sup>2</sup> and Meridian Township officials negotiated an interlocal agreement, signed on March 9, 1983, outlining how the administrative responsibilities and the project benefits (including jobs and tax benefits) would be shared by the City of Lansing and Meridian Township. Meridian Township officials agreed to issue up to \$10 million in industrial revenue bonds for construction of the project.<sup>3</sup> The City of Lansing was allocated a 60-percent share of the projected new jobs and a 65-percent share of the proposed tax revenues generated by the project. Lansing officials agreed to invest or loan at least 15 percent of the recaptured UDAG funds from this project into additional economic development projects in Meridian Township, retaining the rest of the recaptured funds for its own economic development projects.<sup>4</sup> According to the interlocal agreement, Lansing officials were responsible for administering the grant, and Meridian Township officials were responsible for ensuring that the developer complied with the environmental requirements related to the project's construction, establishing job training programs, monitoring the distribution of benefits, and furnishing municipal services to the project.

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**Concerns Raised by HUD's  
Regional Officials During  
Application Phase of the  
Project**

Program officials from HUD's Detroit Area Office, a suboffice of HUD's Chicago Regional Office, raised several concerns about the UDAG application during its review in February 1983. According to a March 1, 1983, memorandum, the Area Office recommended that the grant be approved provided that its concerns were addressed.

HUD Area Office officials expressed concern that the project had no firm commitments from tenants involved in high-technology research for the proposed lease space. Although five high-technology companies and a

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<sup>2</sup>In this report, we use the term "Lansing officials" to refer to both employees of the City of Lansing and employees of Lansing's Economic Development Corporation. According to the corporation's Commercial Industrial Officer, the Economic Development Corporation is technically a separate corporate entity from the city; however, its board is appointed by the Mayor of Lansing and approved by Lansing's City Council, and in general, the corporation's actions are subject to the approval of the government of the City of Lansing.

<sup>3</sup>The industrial revenue bonds were actually issued by Meridian Township's Economic Development Corporation. According to Meridian Township's Community Development Director, although the Economic Development Corporation is technically a separate entity from the Meridian Township government, the township must approve the plans for projects receiving funds from the corporation.

<sup>4</sup>When the UDAG funds are released by HUD, Lansing's Economic Development Corporation will loan the UDAG funds to the developer after receiving the funds from the City of Lansing. The City of Lansing recaptures the funds when the developer repays the loan to the Economic Development Corporation, and the city may use those funds for other economic development projects.

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projections of a prospective tenant and its employment needs.<sup>9</sup> HUD's Detroit Area Office Fair Housing and Equal Opportunity Division criticized the application's minority jobs estimate because Lansing did not use minority census population figures in determining the estimate, but Lansing did not address this complaint.

On April 4, 1983, HUD headquarters officials gave preliminary approval to the UDAG application for the project. According to the Director of the UDAG program, HUD reviewers determined that Lansing's application met UDAG program requirements. Further, from the program's initial grants in 1978 through fiscal year 1983, all qualifying UDAG applications were funded since the demand for funds did not exceed availability. According to the Director of the UDAG program, because Lansing's application met program requirements, HUD officials approved the award of UDAG funds.<sup>10</sup>

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## **Early Difficulties Securing Tenants and Resolving Environmental Issues for the Project**

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### **Loss of Major Tenant Affects UDAG Project's Success**

- **March 1983**—The Lansing Chamber of Commerce created a task force of local industry representatives, which put together a formal proposal to convince the Molecular Biology Institute to locate in the Lansing vicinity.
- **August 1983**—The institute decided to locate in the Lansing vicinity rather than in a competing Michigan community.

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<sup>9</sup>The prospective tenant company expected to employ up to 20 persons in a 5,000-square-foot laboratory, with 11 of those jobs accessible to people with low- to moderate-income backgrounds. Extrapolating to a 154,500-square-foot facility and taking into account the developer's estimates for the facility's need for maintenance and service personnel, the city estimated that 650 new full-time jobs would be generated by the project, with 390 (60 percent) accessible to people with low- to moderate-income backgrounds.

<sup>10</sup>At the beginning of fiscal year 1984, the demand for UDAG funds from eligible communities exceeded program funds to be awarded. As a result, HUD began awarding grants on the basis of a selection system composed of community factors (indicators of economic distress such as the amount of poverty and pre-1940 housing) and project factors such as the number of jobs to be created, the amount of expected private investment, and the expected local tax revenues.

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**Environmental Issues  
Delay Project Construction**

- September 1983—The Environmental Protection Agency (EPA) rejected Lansing's final Environmental Impact Statement and demanded that Lansing submit a supplement addressing its concerns.
- April 16, 1984—HUD canceled its preliminary approval of the application because the environmental issues had delayed the project too long.
- April 27, 1984—HUD reinstated its preliminary approval of the application because it appeared that the problems would be resolved soon.
- November 21, 1984—HUD's Detroit Area Manager informed the Mayor of Lansing that the project's certification of compliance with environmental regulations had been approved.

According to HUD officials, environmental issues surrounding the project needed to be resolved before any UDAG funds could be expended. Throughout 1983 and most of 1984, local citizens groups registered complaints at hearings and pressured EPA to closely scrutinize the environmental impact of the project. EPA rejected the project's draft Environmental Impact Statement<sup>12</sup> in June 1983 and the final Environmental Impact Statement in September 1983. Both Lansing officials and Meridian Township officials believed that EPA's requirements for changing the Environmental Impact Statement were excessive. In October 1983, the Mayor of Lansing asked for HUD's support of Lansing officials' decision not to comply with EPA's demand for a supplemental Environmental Impact Statement; however, HUD officials believed that EPA's concerns needed to be addressed.

On April 16, 1984, HUD canceled its preliminary approval of the UDAG application because of delays caused by the environmental issues. After HUD canceled the grant, Meridian Township officials met with HUD officials to explain the environmental issues and to convince HUD officials to reinstate the grant. On April 27, 1984, HUD reinstated its preliminary approval of the grant, conditioning the reinstatement on resolution of the environmental problems by May 31, 1984; otherwise the preliminary approval would be canceled again.

According to the developer's business development consultant, after the May deadline passed, HUD did not cancel the grant because HUD officials decided to allow more time for resolving the environmental issues. In a November 21, 1984, letter, HUD's Detroit Area Manager informed the

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<sup>12</sup>An Environmental Impact Statement is a written statement describing any significant alteration of environmental conditions, adverse or beneficial, caused or induced by the actions or set of actions, and the alternatives to such actions. The Environmental Impact Statement for UDAG projects, if needed, must be prepared in accordance with the National Environmental Policy Act and associated regulations and Community Development Block Grant regulations.

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Lansing officials were required to submit the documentation necessary for the release of UDAG funds by December 15, 1984.

At the request of Meridian Township officials, HUD officials extended the original deadline for submitting the required documentation to January 31, 1985. The Executive Director of Lansing's Economic Development Corporation did not submit the documentation until March 26, 1985. HUD still required additional materials, evidence of the developer's equity, and some other legal documents which needed to be executed, according to a June 21, 1985, letter from the Executive Director of Lansing's Economic Development Corporation to the developer.

On December 5, 1985, HUD sent a 35-Day Notice of Termination to the City of Lansing because Lansing officials failed to submit all of the required documentation. According to this notice, the Secretary of HUD had the right to terminate the grant if the required documentation was not submitted within 35 days. On January 9, 1986, the Secretary of HUD received a request from Lansing's Chief Assistant City Attorney to amend the project budget. According to HUD officials, it is not uncommon for grant recipients to submit an amendment after receiving a 35-Day Notice of Termination, and HUD normally does not terminate the grant if the proposed changes are justified.

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## **Reduction of the Grant Amount**

- January 9, 1986—Lansing's Chief Assistant City Attorney submitted a revised budget as an amendment to the grant agreement.
- July 10, 1986—A HUD amendment review panel decided to cancel the grant because the total project costs decreased by more than the amount of the grant.
- July 30, 1986—The HUD amendment review panel decided to reduce the grant to \$889,785 instead of canceling the grant in order to protect other project financing.
- September 10, 1986—HUD's Deputy Assistant Secretary for Program Policy Development and Evaluation signed an amendment to the grant agreement to reduce the grant amount to \$889,785.
- October 9, 1986—In a letter to Lansing's Chief Assistant City Attorney, the developer indicated unwillingness to abide by the amendment because total capital equipment expenditures were not reduced to match the reduction in the grant amount, and the developer would have to pay the difference.

Lansing's Chief Assistant City Attorney submitted a revised project budget of approximately \$17 million as an amendment to the grant

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financing,<sup>18</sup> according to HUD officials. On September 10, 1986, HUD's Deputy Assistant Secretary for Program Policy Development and Evaluation signed an amendment to the original grant agreement reducing the grant amount.

According to an October 9, 1986, letter to Lansing's Chief Assistant City Attorney, the developer would not agree to abide by the provisions of the amendment until certain changes were made. The developer objected to the amendment because the cost for the capital equipment remained at \$3.3 million when HUD initially reduced the amount of the grant. According to the amendment, the developer would be expected to cover the difference between the capital equipment costs and the grant from his own equity. The developer wanted the capital equipment costs reduced to the amount of the grant before signing an agreement and submitted proposed budget amendments to implement that change in an October 31, 1986, letter to the Controller of the City of Lansing. On November 6, 1986, Lansing's Chief Assistant City Attorney submitted the developer's proposed changes. According to the Commercial Industrial Officer of Lansing's Economic Development Corporation, Lansing officials did not sign the amendment because the developer did not agree to abide by it.

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## Changes in the Project's Scope

- January 30, 1987—The developer sent a letter to the Mayor of Lansing asking for several additional changes in the grant agreement, including
  - expanding the focus of the project beyond its original high-technology emphasis to include office space leasing,
  - reducing the number of new permanent jobs from 600 to 60, and
  - allowing funds to be spent on movable capital equipment.

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<sup>18</sup>According to HUD officials, if the UDAG had been canceled, the interest earned on the industrial revenue bonds used to fund construction costs would have become taxable. According to Meridian Township officials, if the interest earned on the industrial revenue bonds became taxable, Meridian Township's Economic Development Corporation, might have been liable for damages to the developer because the corporation was obligated in its loan agreement with the developer to protect the tax-exempt status of the industrial revenue bonds.

The Meridian Township bond counsel decided that if the project had \$889,785 in UDAG funds, the industrial revenue bonds would remain tax-exempt. According to the HUD UDAG policy manual, HUD may award a grant specifically for the purpose of giving tax-exempt status to industrial revenue bonds used to finance a project.

size of the grant and to the expenditure of UDAG funds for items other than high-technology research and development equipment. In view of all of the proposed changes in scope, they also demanded a renegotiation of their agreement with Lansing, which established how the two municipalities were to share the expected benefits of the project. According to the letter, Meridian Township officials would not have supported the project at the beginning if they had known how fundamentally the project would change.

HUD officials took no further action on the grant until Lansing's City Attorney submitted the proposed amendment to HUD on April 22, 1987. He asked HUD officials to review both the developer's request and letters expressing the concerns of Meridian Township officials.

## Revised Grant Agreement

- October 23, 1987—HUD's Deputy Assistant Secretary for Program Development signed the revised grant agreement, which (1) reduced both the grant amount and the capital equipment costs from \$3.3 million to \$889,785; (2) reduced the number of new permanent jobs from 600 to 60; and (3) deleted the requirement for the developer to emphasize leasing laboratory space.
- December 22, 1987—The Mayor of Lansing signed the revised grant agreement.
- January 15, 1988—The City of Lansing was required to submit a new complete set of documentation by this date under the revised agreement.
- February 29, 1988—HUD's Deputy Assistant Secretary for Program Development signed an amendment to the revised grant agreement reducing Lansing's share of the tax base from 65 to 51 percent and disallowing the use of UDAG funds for installing the capital equipment.
- July 1, 1988—The developer was to have purchased the capital equipment for the project by this date under the revised agreement.

The revised grant agreement was signed by HUD's Deputy Assistant Secretary for Program Development on October 23, 1987, and the Mayor of Lansing on December 22, 1987. The agreement reduced the grant amount and the total capital equipment costs from \$3.3 million to \$889,785, the amount of developer equity from \$4 million to \$2,351,165, and the number of jobs expected from 600 to 60. The revised agreement also deleted the requirement for the developer to emphasize leasing laboratory space to high-technology companies, instead of adding an emphasis on office tenants, as requested in the proposed amendment. No

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According to HUD officials, neither the City of Lansing nor the developer met the June 14, 1988, deadline.

HUD officials said that they attempted to resolve the documentation issue over the telephone, but Lansing's City Attorney, in a September 27, 1988, letter, requested that HUD advise the City of Lansing of the grant's status in writing. On October 26, 1988, HUD's Assistant General Counsel for Action Grants sent Lansing's City Attorney a letter listing the remaining documentation problems.

An attorney from HUD's Office of the General Counsel suggested to both Lansing officials and the developer that, as an alternative plan, the revised grant agreement could be amended to allow the developer to spend the UDAG funds on construction costs instead of on capital equipment costs. According to the Director of the UDAG program, on a noncontroversial grant this solution would probably have been adopted. On September 27, 1988, the developer asked the Mayor of Lansing to request an amendment to the grant agreement allowing the UDAG funds to be applied toward construction costs. However, the Executive Director of Lansing's Economic Development Corporation told us that the City of Lansing would not submit a grant amendment of this nature to HUD. He believed that restricting the use of the UDAG funds for fixed capital equipment would help maintain the project's original "high-technology" focus.

In a series of meetings with us in November 1988, officials of HUD, Lansing, and Meridian Township, and representatives of the developer expressed their willingness to implement the grant agreement. However, according to HUD officials, Lansing officials must first submit the additional documentation to HUD necessary to process the grant, and the developer must secure one or more tenants for the project capable of using the fixed capital equipment to be purchased with the UDAG funds. HUD officials agreed that a considerable amount of time has passed since Lansing's grant was approved and that they should implement or terminate the grant.

According to HUD officials, as of February 1989, the UDAG funds had not been released to the City of Lansing. They said that Lansing officials must submit documentation required by the grant agreement, including the UDAG loan agreement between the city and the developer, but Lansing officials have agreed to submit the remaining documentation after HUD officials act to establish new deadlines for the developer to purchase the capital equipment. According to a UDAG development officer at

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HUD, the developer has submitted a list of capital equipment totaling \$281,087 that meets UDAG program requirements, but the developer still needs to find one or more tenants to use the equipment to be purchased with the remaining UDAG funds.

In January 1989, HUD officials told us that they intend to take the following approach to moving the grant process forward. First, HUD officials will set new deadlines for the City of Lansing to submit the remaining required documentation and for the developer to purchase the fixed capital equipment specified in the grant agreement, as requested by Lansing in a January 1989 letter. Second, if Lansing officials submit all of the required documentation, HUD will arrange for the release of the UDAG funds. Third, if either the City of Lansing or the developer does not meet the new deadlines, HUD officials may take action to bring the grant to closure, including exercising their option to terminate the grant. As of February 1989, a UDAG development officer at HUD said that HUD officials were working to establish deadlines for the City of Lansing to submit the required documentation and for the developer to purchase the capital equipment.

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changes were made regarding the types of equipment that could be purchased with the UDAG funds. On February 29, 1988, HUD's Deputy Assistant Secretary for Program Development signed an amendment to the revised agreement that reduced Lansing's share of the tax revenues from 65 to 51 percent and disallowed the use of UDAG funds for installing the capital equipment.

The revised grant agreement reset some deadlines from the original grant agreement. According to an attorney from HUD's Office of the General Counsel, because the revised agreement was a complete revision and not just an amendment, it required a new complete set of documentation from Lansing, which Lansing was to submit by January 15, 1988. The deadline for purchasing and installing the capital equipment changed from December 31, 1986, to July 1, 1988.

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## Current Status

- May 3, 1988—HUD officials set a June 14, 1988, deadline for Lansing officials to submit the additional documentation required by the revised grant agreement and for the developer to get firm commitments from a tenant who could use the capital equipment to be purchased with the UDAG funds.
- September 27, 1988—The developer asked the Mayor of Lansing to request an amendment allowing the UDAG funds to be used toward construction costs.
- October 26, 1988—HUD's Assistant General Counsel for Action Grants sent Lansing's City Attorney a letter listing the remaining problems in the required documentation.
- November 1988—In a series of meetings with us, officials of HUD, Lansing, and Meridian Township, and representatives of the developer expressed their willingness to implement the grant agreement.
- February 1989—HUD officials told us that they were in the process of establishing deadlines for the developer to purchase the capital equipment, as requested by Lansing in a January 1989 letter.

According to Lansing officials, HUD officials attempted to resolve the situation in a May 3, 1988, conference call, which included representatives from the UDAG program, HUD's Detroit Area Office, HUD's Office of the Inspector General, the City of Lansing, and the developer. As a result of the conference call, Lansing officials understood that they needed to correct the problems with the documentation required by the grant agreement before June 14, 1988, and the developer's representatives understood that they needed to find a tenant who could use the capital equipment to be purchased with UDAG funds before June 14, 1988.

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- February 27, 1987—The Supervisor of the Charter Township of Meridian sent a letter to the Mayor of Lansing protesting the changes proposed in the developer's letter and asking for Lansing officials to withdraw Lansing's UDAG application.
- April 22, 1987—Lansing's City Attorney asked HUD officials to review the amendment request.

In a January 30, 1987, letter to the Mayor of Lansing, the developer requested changes to the grant agreement in addition to the budget changes requested in November 1986. Specifically, the developer requested expanding the focus of the project beyond its original high-technology emphasis to include office space leasing. According to the letter, the Molecular Biology Institute decided not to locate in the project and the developer had not been able to attract another high-technology research tenant to the project.

In the meantime, the developer had leased office space in the project to a variety of companies not generally considered to be involved in high-technology research. According to the developer, space had been leased to conventional office tenants in order to collect income from the project. While maintaining that the facility could still support high-technology research clients, the developer also wanted to continue to lease conventional office space.

In the January 30, 1987, letter, the developer also stated that the number of new jobs expected to result from the project had decreased from 600 to 60 for two reasons. First, the original job calculations were unrealistic because the estimate included preexisting jobs transferred from other locations. Thus, not all the expected jobs were newly created jobs. Second, the developer expected that conventional office tenants would create less jobs than newly expanding high-technology research firms.

In the letter, the developer also asked to be allowed to purchase certain types of movable equipment with UDAG funds—satellite communications equipment, television production equipment, computer equipment, and office equipment purchased in connection with the previously listed equipment.

In a February 27, 1987, letter to the Mayor of Lansing, Meridian Township officials strongly objected to the changes proposed in the developer's letter and asked the City of Lansing to withdraw its application for the grant. The officials specifically objected to the reduction in the

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agreement on January 9, 1986.<sup>15</sup> Under UDAG regulations, Lansing officials were required to submit the amendment because the budget changes were greater than 10 percent of the grant amount. HUD officials reviewed the revised budget in conference calls with the developer and Lansing officials.

Upon reviewing the revised budget, HUD officials disallowed over \$3.7 million in project costs<sup>16</sup> and recommended a total project budget of about \$13.3 million. Because the total project costs decreased by more than the amount of the grant, HUD officials believed that the \$10 million in industrial revenue bonds and \$4 million in developer equity would be sufficient to cover both the construction-related and the capital equipment costs of the project, and that, consequently, UDAG funds were no longer needed.<sup>17</sup> For that reason and because the UDAG legislation required that HUD award the least amount of UDAG funds necessary to carry out a project, HUD officials considered canceling the grant on July 10, 1986.

HUD's decision to cancel the grant was never fully processed after the developer informed HUD officials that canceling the grant would affect other project financing. On July 30, 1986, HUD instead reduced the grant to \$889,785, the minimum amount needed to protect the other project

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<sup>15</sup>In a November 21, 1984 letter, the Commercial Industrial Officer of Lansing's Economic Development Corporation questioned whether HUD would consider certain project costs included in the new detailed project budget as eligible costs to be associated with private funds under the UDAG grant agreement. The official was concerned that if the eligible costs to be associated with private funds under the grant agreement were less than \$14 million at the completion of the project, the amount of the UDAG would be reduced.

<sup>16</sup>The costs disallowed by HUD officials included the interest on the industrial revenue bonds, payments on the land for the project site, certain annual fees, legal fees paid to the developer's attorneys for general advice, the salaries of the developer's employees working on the project, contingency costs, and developer profit and overhead costs.

<sup>17</sup>The total project budget was \$17.3 million under the original grant agreement and about \$17 million in the project budget submitted in January 1986. HUD's recommended total project budget, after deducting the disallowed costs, was approximately \$3.7 million less than the Lansing officials requested and about \$4 million less than the project costs under the original grant agreement.

Mayor of Lansing that the project's certification of compliance with environmental regulations had been approved, effective September 26, 1984.

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## Original Grant Agreement

- September 13, 1984—HUD's Deputy Assistant Secretary for Program Management, Office of Community Planning and Development, signed the original grant agreement, approving the award of a \$3.3 million grant to the project.
- October 24, 1984—The Mayor of Lansing signed the original grant agreement.
- December 15, 1984—The City of Lansing was required to submit all of the additional documentation specified in the agreement by this date.
- March 26, 1985—The Executive Director of Lansing's Economic Development Corporation submitted documentation required in the agreement, but HUD still required additional materials, according to a June 21, 1984, letter from the Executive Director of Lansing's Economic Development Corporation to the developer.
- December 5, 1985—HUD informed the City of Lansing that the Secretary of HUD could terminate the grant if the City of Lansing did not submit the required documentation within 35 days.

The original grant agreement was signed by HUD's Deputy Assistant Secretary for Program Management, Office of Community Planning and Development, on September 13, 1984, and by the Mayor of Lansing on October 24, 1984. According to the grant agreement, the total project budget was \$17.3 million, with \$14 million in construction-related project costs to be financed by \$4 million in developer equity and by \$10 million in tax-free industrial revenue bonds,<sup>13</sup> and \$3.3 million in capital equipment costs to be financed by the grant. The grant agreement restricted the use of UDAG funds to the purchase and installation of fixed capital equipment.<sup>14</sup> In addition, the developer was required to lease and manage the project "with emphasis on leasing laboratory space to small companies specializing in hi-technology research and development."

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<sup>13</sup>In general, interest earned on industrial revenue bonds is tax-free only if the costs of the project financed are \$10 million or below. However, on projects financed in part with UDAG funds, the interest earned on the industrial revenue bonds remains tax-free if the costs of the project are \$20 million or below. According to the UDAG application, the UDAG was needed to finance part of the gap between the \$10 million in bonds and the projected \$20 million project cost. The application also stated that the UDAG was needed to permit the bonds to be tax-exempt.

<sup>14</sup>According to UDAG policy, the capital equipment purchased with UDAG funds for the project may not include equipment that is movable or has a useful life of less than 7.5 years for federal tax purposes. Items such as office equipment or minor tools may not be purchased with UDAG funds.

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- **March 1984**—After it could not agree on leasing terms with the developer, the institute decided to locate on land donated by Michigan State University instead of at the Hannah Technology and Research Center.

Meridian Township officials and the developer expected that the Molecular Biology Institute<sup>11</sup> would come to the Hannah Technology and Research Center and be the major or “anchor” tenant capable of drawing other high-technology tenants to the project. In March 1983, after the institute received a proposal to locate in Battle Creek, Michigan, from a nonprofit community development group in Battle Creek, Lansing’s Chamber of Commerce responded by creating a task force of local industry representatives, which put together a formal proposal to convince the institute to locate in Lansing. The proposal stated that Lansing would provide the institute with a prime site at no cost, and it listed the Hannah Technology and Research Center as one of three alternative sites in the Lansing area.

On August 12, 1983, the institute announced its decision to locate in Lansing rather than Battle Creek, but it did not choose a specific site in the Lansing area. The developer and his representatives told us that they could not agree to the lease terms because the institute wanted 15 free acres to construct its own building, and the developer was willing to give up only 5 acres. According to Meridian Township officials and Michigan State University officials, in March 1984, after Michigan State University offered the institute 15 acres of its land free, the institute decided to locate there instead of in the Hannah Technology and Research Center.

Despite the loss of the prospective major tenant, project development continued. The developer believed and Lansing officials and Meridian Township officials said that they believed that the project could still be successful because it could attract other biotechnology tenants who wished to be located near the Molecular Biology Institute.

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<sup>11</sup>The Molecular Biology Institute, which later changed its name to the Michigan Biotechnology Institute, was established in 1981 by a state high-technology task force. The institute is a nonprofit research center specializing in the development of commercial uses for biotechnology. According to the Director of Lansing’s Economic Development Corporation, many communities close to universities were interested in having the institute in their vicinity because the institute had the potential to generate jobs and tax revenues from both itself and other biotechnology companies it might attract.

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research institute had expressed various degrees of interest in occupying the completed facility, none had firmly committed themselves to sign a lease.<sup>5</sup> However, according to HUD officials, HUD does not require firm commitments for leasing space unless other project financing depends upon them, and the Lansing project's other financing carried no such condition.

HUD Area Office officials also raised concerns about the lack of documentation regarding some financing of the project.<sup>6</sup> According to UDAG regulations, an acceptable application requires evidence of at least firm private financing commitments and, if needed, firm public financing commitments. The developer's \$4 million cash equity<sup>7</sup> commitment was not supported with firm and documented written evidence from the company's banking institution. According to a UDAG development officer at HUD, the statement of commitment of equity in the developer's letter included in the UDAG application package probably qualified as a firm private commitment under the policy that existed at that time, although it would not qualify under current HUD policy.<sup>8</sup> In addition, according to the Area Manager, loans from state and local sources totaling \$2.7 million were not documented with firm letters of financial commitment. These loans never materialized and were dropped from the program budget before the grant agreement was signed in 1984.

HUD Area Office officials also believed that the City of Lansing needed to provide more accurate calculations for the total new permanent jobs expected, the proportion of those jobs accessible to people with low- to moderate-income backgrounds, and the proportion of those jobs expected to go to minorities. On March 16, 1983, Lansing officials responded to these concerns by submitting additional evidence documenting the total and low- to moderate-income job calculations. According to this evidence, the job calculations were based on the new job

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<sup>5</sup>According to the developer's business development consultant, only one of the companies expressing an interest in occupying the facility actually leased space from the project.

<sup>6</sup>The UDAG regulations require firm commitments, which are documents that commit the participating parties in the project to specific activities or financing and show that the investment will occur contingent upon the award of the UDAG. The parties must also state their willingness to make the commitments legally binding once the application is granted preliminary approval.

<sup>7</sup>According to HUD's UDAG policy manual, "equity is cash and other assets donated to the project not including debt secured by the project."

<sup>8</sup>According to HUD officials, the UDAG policy manual was revised in 1986 to strengthen the UDAG program requirements in general, including the requirements for firm commitments.

# Events Associated With the Urban Development Action Grant Awarded to Lansing, Michigan

This appendix discusses the chronology of events associated with an Urban Development Action Grant (UDAG) approved for Lansing, Michigan, in 1984 by the Department of Housing and Urban Development (HUD). The original purpose of the grant was to finance the purchase and installation of fixed capital equipment for use in the Hannah Technology and Research Center located in Meridian Township, Ingham County, Michigan. The intent of this project was to attract businesses that could base their research on the new technologies under development at nearby Michigan State University. According to HUD officials, as of February 1989, the UDAG funds had not yet been released to the City of Lansing because Lansing officials had not submitted documentation required by the grant agreement, which HUD must approve before releasing the funds.<sup>1</sup>

## Application and Review Process for Lansing's Grant

- January 27, 1983—The City of Lansing submitted an application to HUD for a \$3.3 million grant for the Hannah Technology and Research Center project.
- February 1983—HUD regional officials raised concerns about Lansing's UDAG application as a result of their reviews.
- March 9, 1983—The City of Lansing and Meridian Township entered into an interlocal agreement that outlined how they would share the administrative responsibilities and the project benefits (including jobs and tax benefits).
- April 4, 1983—HUD gave its preliminary approval of Lansing's UDAG application.

On January 27, 1983, the City of Lansing applied for a \$3.3 million grant for the Hannah Technology and Research Center project. Although the project site was in Meridian Township, a suburb of Lansing, the City of Lansing applied for the grant on behalf of Meridian Township because Meridian Township did not meet the UDAG program's eligibility criteria. Program regulations and policies allow the closest eligible community to apply for a grant on behalf of an ineligible community as long as the applicant receives the required amount of benefits from the project.

<sup>1</sup>The required documentation, called "legally binding commitments," shows a legally binding and enforceable commitment on the part of one or more participating parties in the project to implement specific project activities and to invest a specific amount in the project and prove that the party actually has or will have available the finances it has agreed to invest in the project.

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## Abbreviations

EPA	Environmental Protection Agency
GAO	General Accounting Office
HUD	Department of Housing and Urban Development
UDAG	Urban Development Action Grant

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## Changes in Other UDAG Projects

HUD officials told us that the changes to the City of Lansing's grant are not unusual. The Director of the UDAG program told us that reducing or changing the scope, grant amounts, and expected benefits (including jobs and tax revenues) of UDAG projects is a common practice affecting many communities that have been awarded such grants. At our request, a HUD official identified those projects that have been amended. Of the approximately 1,350 completed projects, about 980 projects had been amended at least once, as of February 1989.

According to HUD officials, UDAG projects are largely privately financed economic development projects (to be eligible for a grant, each project must have at least \$2.50 in private funds for every UDAG dollar) and are often affected by changes in economic conditions and project financing. Further, grant agreements are often amended after a project is completed to incorporate all the changes that have occurred in the project since the original agreement was signed.

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## Conclusions

HUD officials have told us that the changes in the scope of Lansing's UDAG project are not uncommon and have occurred with other UDAG projects. Further, HUD's regulations, policies, and procedures allow for these changes and give program personnel broad discretion in administering the grant. With respect to Lansing's grant, HUD officials agreed to the various proposed changes to accommodate the parties involved and to ensure the success of the project.

According to HUD officials, Lansing's grant agreement could be implemented without any further changes to the project. However, Lansing officials must first submit documentation required by the grant agreement, and the developer must secure one or more tenants for the project capable of using the fixed capital equipment that is to be purchased with the UDAG funds. HUD officials agreed that a considerable amount of time has passed since Lansing's grant was approved and that they should implement or terminate the grant. The actions that HUD officials told us they plan to take to move the grant process forward seem reasonable. However, as of February 1989, HUD had not yet taken the necessary actions.

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## Recommendations

We recommend that HUD officials implement their plan to set new deadlines for the City of Lansing to submit the remaining documentation and for the developer to purchase the capital equipment with the UDAG funds. If either the City of Lansing or the developer does not meet the

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## Reduction in Proposed Jobs

In the January 30, 1987, letter, the developer also stated that the number of new jobs expected to result from the project had decreased from 600 to 60 for two reasons. First, the original job calculations were unrealistic because the estimate included preexisting jobs transferred from other locations. Thus, not all the expected jobs were newly created jobs. Second, the developer expected that conventional office tenants would create less jobs than newly expanding high-technology research firms.

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## Meridian Township Officials' Objections to Proposed Changes in the Grant Agreement

In a February 27, 1987, letter to the Mayor of Lansing, Meridian Township officials objected to the reduction in the grant amount and the changes proposed in the developer's letter and asked the City of Lansing to withdraw its application for the UDAG funds. The officials specifically objected to the reduction in the amount of the grant from \$3.3 million to \$889,785 and to the expenditure of the UDAG funds for items other than high-technology research and development equipment. In view of all of the proposed changes in scope, they also asked for a renegotiation of their agreement with Lansing, which established how the two municipalities were to share the expected benefits of the project. According to the letter, Meridian Township officials would not have supported the project at the beginning if they had known how fundamentally the project would change.

Despite Meridian Township officials' objections, Lansing's City Attorney submitted the proposed amendment to HUD. In an April 22, 1987, letter, he asked HUD officials to review the developer's proposed amendments and letters documenting Meridian Township officials' concerns. In May 1987, after the project construction was substantially complete, HUD officials reviewed the proposed changes. Subsequently, they revised the grant agreement to reduce the grant amount and the number of jobs expected from the project and delete the provision that the project must be managed "with emphasis on leasing laboratory space to small companies specializing in hi-technology research and development." A revised grant agreement incorporating these changes was signed by HUD's Deputy Assistant Secretary for Program Development on October 23, 1987, and by the Mayor of Lansing on December 22, 1987.

tenants and reduced the number of proposed jobs from 600 to 60. HUD officials incorporated these changes into a revised grant agreement signed by HUD and Lansing officials in 1987. HUD's regulations, policies, and procedures allow for such changes and give program personnel broad discretion in administering the grants.

According to HUD officials, as of February 1989, the UDAG funds had not been released to the City of Lansing. They said that Lansing officials must submit documentation required by the grant agreement, including the UDAG loan agreement between the city and the developer, before HUD releases the funds.

With regard to other grants, HUD officials told us that the changes to Lansing's grant were not unusual. They also said that changing the scope, grant amount, and expected project benefits of such grants is a practice affecting many communities that have been awarded UDAG funds.

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## Background

The UDAG program, administered by HUD, was established by the Housing and Community Development Act of 1977 (P.L. 95-128) and is designed to foster private investment in development projects in economically distressed communities. Essentially, the program provides funding on an individual project basis to distressed communities that then lend the funds to private developers, thus improving the feasibility of economic development projects that would otherwise be marginal. Program regulations and policies allow the closest eligible community to apply for a grant on behalf of an ineligible community as long as the applicant receives the required amount of benefits from the project. According to program regulations, the community that is awarded the grant is responsible for fulfilling the requirements of the grant agreement.

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## Reduction in the Grant Amount

According to the original grant agreement, the total project budget was \$17.3 million. Fourteen million dollars in construction-related costs was to be financed by \$4 million in developer equity and by \$10 million in tax-free industrial revenue bonds, and \$3.3 million in capital equipment costs was to be financed by the grant.

In January 1986, Lansing's Chief Assistant City Attorney submitted a revised budget of about \$17 million. Upon reviewing the budget, HUD disallowed approximately \$3.7 million in project costs and recommended

