TO: State of California Department of Housing and Community Development
FROM: Enterprise Advisors
DATE: February 2, 2018
RE: Analysis of State CDBG Policies

Background and Methodology

As a component of the U.S. Department of Housing and Urban Development (HUD) Technical Assistance Work Plan for the State of California Community Development Block Grant (CDBG) program, Enterprise Advisors prepared a comparative analysis of California Code of Regulations Title 25 §7050-7126 and 24 Code of Federal Regulations Part 570 Subpart I.

In addition, Enterprise has been asked to compile a list of areas where HCD may be interpreting or applying those state and federal regulations more stringently than necessary. This review of policies consisted of reviewing State of California Department of Housing and Community Development (HCD) CDBG documents, including the CDBG Grants Management Manual, Management Bulletins, NOFA documents and Checklists of General Conditions. The review process also included attendance at CDBG Redesign Working Group meetings on October 6, December 8, 2017 and conference calls on October 30, November 3, and November 17, 2017. In addition, phone conversations were held with Karen Patterson of HCD and Terry Cox of Cox Consulting.

Observations and Recommendations

1) Allocation and Awards

a. Set-asides are a common practice in state programs. To ensure timely expenditure of funds, HCD should look at the timing of the release of those funds to other activity types as soon as allowable under state regulations.

b. HCD is in the NOFA stage, and began accepting applications on December 1st, for 2017 Program Year (PY) funds. Although PY2017 funds were delayed by HUD this year, HCD should look at the timing of application and award to coincide with the receipt of federal funds. For example, states with July program years frequently begin the application cycle Jan-Mar and make awards as early as May-Jul, conditioned on receipt of federal funds. Additionally, HCD may want to take the “construction season” (if applicable) into account in the award/approval of funds.

c. HCD will need to be more cognizant of milestones and deadlines as unexpended PY2015 funds and forward will be swept by HUD in 2022, which is not very far away.
2) Program Income:

   a. HCD is currently requiring all Program Income (PI) on hand to be spent per draw request regardless of the activity for which claims are requested. Although this has the appearance of reducing PI on hand for active grantees, it increases the unexpended treasury funds balance.

   b. HCD requires that a grantee have an open contract to expend PI. This is currently interpreted as one of the following: 1) an open Standard Agreement with obligated treasury funds that includes “supplemental” activities; 2) an approved PI Reuse Agreement (currently open for 10 years) that identifies specific activities to be undertaken; or 3) a waiver approval for additional activities not included in the PI Reuse Plan. The process and its impact on expenditure of funds is complex and it does not appear that all HCD staff or local governments have an understanding of the process.

If a unit for general local government (UGLG) has any PI on hand, they may still apply for treasury funds. Any PI on hand is utilized on the project, until the PI balance is $0. Should additional PI be received by the UGLG during the life of the Standard Agreement contract they must use those funds first.

In some instances, this severely impacts the expenditure of treasury funds. It also hampers the ability of UGLGs to maintain ongoing programs. The process itself is extremely time consuming for both HCD and UGLGs. HCD has the ability to allow UGLGs to maintain PI on hand if it is deemed likely to be applied to continue the activity within the reasonably near future” (24 CFR 570.489(e)(3)(ii)(A)). HCD should come up with a definition of reasonable PI on hand and allow UGLG’s with active PI Reuse Agreements to continue those activities. Any activities the UGLG chooses to do outside the approved PI Reuse Plan could either apply for treasury funds or submit a request to include an additional activity. This could be done with a PI Reuse Agreement amendment or a separate project specific contract with defined milestones (non-ongoing activities).

Example #1: A UGLG has $300,000 in PI funds on hand. The UGLG has an approved PI Reuse Agreement to do housing rehab and housing counseling. The UGLG is requesting $1,000,000 in treasury funds for a sewer project. HCD has determined the reasonable amount of PI on hand should be no more than $200,000. If the UGLG is selected for award, they would receive $900,000 in treasury funds and utilize $100,000 in PI.

Example #2: An UGLG has $300,000 in PI. The PI Reuse Agreement is for housing activities only. The UGLG would like to do $200,000 in necessary improvements to sidewalks and curb-cuts for ADA compliance. The UGLG requests a “waiver” or
“amendment” to the PI Reuse Agreement for the use of PI on the eligible activity. HCD approves the application and issues a $0 fund contract with established dates and deadlines for the use of $200,000 of PI and the UGLG keeps the $100,000 remaining on hand for the continuation of housing activities.

Example #3: An UGLG has $200,000 in PI on hand. The UGLG submits an application to do a sewer project for $1,500,000 and removal of architectural barriers for $200,000. HCD approves the application and awards $1,500,000 in treasury funds and the use of the PI. Both projects should be subject to the same readiness requirements and milestones for completion.

In all scenarios, HCD must have a policy on the amount of funds that can be reasonably expected to be used in the foreseeable future. This can be one set amount or a different level for different ongoing activities (e.g., housing vs economic development).

It is important for HCD to establish policies concerning: 1) the amount of funds allowed to be kept for “ongoing” activities (as defined by HCD); 2) the length of time between activities HCD continues for activities to be “ongoing”; 3) the approval of PI projects to ensure they have milestones for readiness and completion.

c. PI that is deemed by HCD to be in non-compliance with 24 CFR 570.489(e)(3)(ii)(A) as “unlikely to be applied to continue the activity within the reasonably near future” could be returned to the state or allocated to another UGLG project. HCD could establish a timeframe in the Consolidated/Action Plan that limits how long UGLGs may retain funds on hand without progress on the activity (such as expenditure of funds) before they are required to return them to HCD for reallocation.

3) Readiness Requirements:

a. The State regulations currently have specified evaluation criteria for applications under each category of funding. However, the specific criteria used per project type is not directly related to the readiness of the project to proceed, (e.g., environmental review completed, site control, financing, preliminary design, etc.). Operator experience currently is included as an evaluation criterion; however, it is not a readiness factor, but rather a capacity factor. It does not appear that HCD is actually reviewing readiness as a component of scoring.

b. HCD currently requires UGLGs to complete a General Conditions Checklist (per project type) prior to Release of Funds. However, there is no time limit for UGLGs to complete the general conditions. The time to complete the general conditions is often protracted in part because HCD does not have a process for
allowing/reimbursing pre-agreement costs or a requirement for a local funding match. That means, UGLGs often do not start the process of completing the general conditions--including design, financing, procurement of consultants, etc.--until after award. HCD should consider allowing/reimbursing pre-agreement costs and/or requiring a local match to expedite the completion of the general conditions and the implementation of the activity upon award. For example, HCD could issue approval for the UGLG to undertake (and be reimbursed for) pre-agreement steps (such as environmental review) on all exempt activities at their own risk until final clearance of the General Conditions Checklist.

c. As stated above, many UGLGs do not begin steps such as design, environmental review, and financing until after award. And because there are no readiness requirements or criteria for evaluation in the applications, frequently, it only becomes apparent the proposed activity is not feasible as planned after award has been made. HCD currently allows the UGLG to completely change the activity through a contract amendment and start a new project instead of de-obligating and reallocating the awarded funds. It is presumed that having to start over with a completely new activity would delay the timeline and have a huge impact on the rate of expenditures.

HCD could allow for a more expanded use of Planning Only grants and PI for the use of Planning Only activities to complete certain readiness activities before large amounts of treasury funds are obligated. It is understood that the cost of the Environment Review Record (ERR) in California is frequently substantially higher than in many areas of the country. Allowing Planning Only grants that include the completion of the ERR would reduce this burden from the UGLG and reduce the obligation of funds on projects that will have a long lead time before construction.

4) Eligible Activities:

a. The State regulations appear to limit the eligible activities that may be undertaken with CDBG funds. If deemed eligible, many of these currently ineligible activities, including fast spending activities like environmental remediation or demolition, would improve the expenditure of funds. In addition, supplemental activities are further restricted. Allowing UGLGs to use PI for small public infrastructure projects, such as sidewalks, could increase expenditures of locally held funds dramatically over a short period of time.

b. Although allowable under State and Federal regulation, HCD appears to have limited all activities to the Low and Moderate Income national objectives. Planning-only activities are restricted to the LMA national objective. Expanding the allowable national objectives and greater use of planning-only activities could increase expenditures.
5) Administrative Cap
   
a. Currently, HCD does not allow UGLGs to retain administration fees on Revolving Loan Funds (RLF) or continuing programs like Owner Occupied Rehabilitation (OOR). This creates an administrative burden on the UGLG to operate a program, compromising its ability to expend funds. Allowing the UGLG to retain general administration fees will also increase the PI spend.

b. The State currently allows up to 7.5% of a grant amount to be used for general administration. Nationally, this amount is anywhere between 5 percent and 18 percent. Increasing the amount allowable for general administration will increase expenditures. HCD could consider higher general administration amounts on specific activity types that have a heavier administrative burden.

6) Cross-cutting Requirements
   
a. The State adopted Part 85 for procurement for UGLGs. Part 85 is now 2 CFR 200. HCD should review its interpretation of the regulations as they are implementing a stricter interpretation than necessary for both RFP/RFQ and Conflict of Interest. However, prescriptive procurement policies can have some advantages, such as reducing the need and time required for review. HCD should consider how best to balance these two elements.

b. HCD could consider the use of Lump Sum draws and Escrow accounts for programs that meet the requirements at 24 CFR 570.511 and 24 CFR 570.513.