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Audit Report Number  
2009-LA-1005

TO: William Vasquez, Director, Community Planning and Development, 9FD

*Joan S. Hobbs*

FROM: Joan S. Hobbs, Regional Inspector General for Audit, 9DGA

SUBJECT: The City of San Diego, California Did Not Administer Its Community Development Block Grant Program in Accordance with HUD Requirements When Funding the City's Redevelopment Agency Projects

## **HIGHLIGHTS**

### **What We Audited and Why**

We selected the City of San Diego's (City) Community Development Block Grant (CDBG) program for audit in response to a hotline complaint. The citizen complainant alleged that the City's Redevelopment Agency (Agency) had received loans from the City's CDBG program dating back to the 1970s and that the loans had accumulated interest in violation of applicable U.S. Department of Housing and Urban Development (HUD) rules and regulations. Our main objective was to address the citizen complaint and determine whether the City administered its CDBG loans issued to the Agency in accordance with HUD rules and regulations.

### **What We Found**

The City failed to properly administer its CDBG funds provided to the Agency in accordance to HUD requirements. For the 35 redevelopment projects sampled as part of our review, almost \$13 million in CDBG costs was questionable, including more than \$1.8 million in ineligible and \$11 million in unsupported costs.

The City did not enter into required agreements with the Agency or list the projects in the action plan or subsequent amendments to HUD and failed to monitor the project activities as required by HUD regulations.

The City also issued legitimate loans to the Agency to fund 35 CDBG activities for eight project areas using mostly program income funds. However, it failed to execute loan agreements and repayment schedules for the CDBG loans issued to the Agency with an overall principal balance of more than \$63 million and an accumulated interest balance of more than \$76 million. The Agency did not make consistent good faith efforts to repay the CDBG loans to the City and primarily used the debt to leverage/obtain state tax increments.

### **What We Recommend**

We recommend that the Director of the Office of Community Planning and Development require the City to

- Pay back more than \$1.8 million plus any applicable interest to HUD from nonfederal funds for CDBG project costs determined to be ineligible.
- Provide supporting documentation for unsupported redevelopment project activities or reimburse its program more than \$11 million from nonfederal funds.
- Execute written interagency agreements and loan agreements with the Agency for outstanding loans totaling more than \$139 million.
- Implement written procedures and controls to ensure timely payments on CDBG loans, that the City and the Agency adequately monitor CDBG activity and maintain adequate supporting documentation, and all future redevelopment projects are included in the action plan or amendments.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

### **Auditee's Response**

We provided a draft report to City officials on November 19, 2008 and requested their response by December 8, 2008. We discussed the results of our review during the audit and at an exit conference on December 2, 2008. City officials provided their written comments on December 8, 2008. They generally disagreed with the draft report findings. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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## **BACKGROUND AND OBJECTIVES**

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The Community Development Block Grant (CDBG) program was established by Title I of the Housing and Community Development Act of 1974 (Public Law 93-383). The program provides grants to state and local governments to aid in the development of viable urban communities. Governments are to use grant funds to provide decent housing and suitable living environments and to expand economic opportunities, principally for persons of low and moderate income. To be eligible for funding, every CDBG-funded activity must meet one of the program's three national objectives.

- (1) Benefit low-and moderate-income persons.
- (2) Aid in preventing or eliminating slums or blight, or
- (3) Address a need with a particular urgency because existing conditions pose a serious and immediate threat to the health or welfare of the community.

### The City of San Diego

The City of San Diego (City) is a CDBG entitlement recipient and according to the U.S. Department of Housing and Urban Development (HUD) Integrated Disbursement and Information System,<sup>1</sup> the City has received an average of \$17.9 million (excluding program income) in CDBG funds annually during the past eight years. These funds are available to support a variety of activities directed at improving the physical condition of neighborhoods by providing housing or public improvements/facilities, fostering economic development by providing technical and financial assistance to local businesses, creating employment, or improving services for low- and/or moderate-income households.

The City is a diverse city of urban and suburban communities. Eight council districts participate in the City's CDBG program. Several nonprofit organizations also receive CDBG funds from the City to help carry out activities. Until fiscal year 2007, the City's Community Services Division administered the CDBG program and was in charge of overseeing and monitoring subgrantees, as well as directly delivering CDBG-funded activities. Currently, the Department of City Planning and Community Investment is responsible for the administration of the CDBG program. This newly constituted department combines planning, economic development, and redevelopment to integrate the City's development strategy, policies, and visioning processes with some of its major implementation tools. It is organized into four divisions, Community Planning, Urban Form Planning, Economic Development, and Redevelopment each led by a deputy director. The Economic Development division manages the City's CDBG program.

### The City's Redevelopment Agency

The Redevelopment Agency (Agency) was created by the city council in 1958 to alleviate conditions of blight in older, urban areas by state authority defined in California's Health and Safety Code (section 33000-et.seq.), also known as the California Community Redevelopment Law.

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<sup>1</sup> The Integrated Disbursement and Information System is a real-time, mainframe-based computer application used by grantees to enter, maintain, and report on projects and activities that support HUD's community planning and development formula grant programs including CDBG.

The Redevelopment Division of the Community and Economic Development Department serves as staff to the Agency. The Agency oversees 17 redevelopment project areas, encompassing more than 8,000 acres. In addition, it administers seven project area committees that advise the Agency regarding plan adoption and project implementation activities. An additional two corporations assist the Agency with redevelopment activities.

- (1) Southeastern Economic Development Corporation is an independent corporation in charge of all redevelopment activities within a seven-square-mile area immediately east of downtown San Diego, in the community known as southeastern San Diego. Established in 1981 by the City, it is responsible for four adopted redevelopment project areas and one study area.
- (2) Centre City Development Corporation is a public, nonprofit corporation created by the City to staff and implement downtown redevelopment projects and programs. Formed in 1975, the corporation serves on behalf of the Agency as the catalyst for public-private partnerships to facilitate redevelopment projects adopted pursuant to redevelopment law.

#### HUD's 2007 Review of City's CDBG Program

HUD's Office of Community Planning and Development performed a monitoring review in fiscal year 2007 and identified several problems with the City's administration of the CDBG program, including (1) no single audits performed by the City since fiscal year 2004, (2) lack of supporting documentation, and (3) no minimum funding amounts for sub-recipients. To help address the problems with the CDBG program, the City's mayor transferred administration responsibilities from the Community Services to the Economic Development department on July 1, 2007. The City's economic development deputy director informed us that the city council has since had hearings on CDBG reform. The City was trying to put together a comprehensive plan for reform to address problems identified by HUD and the City. The City has an interim reform (remedial approach) plan to address HUD findings and concerns that will keep the CDBG program compliant for fiscal year 2009 and will develop a comprehensive program that will be put into full implementation for fiscal year 2010. The comprehensive program will include policies and procedures for allocations, monitoring, etc. The goal is to have one group plan CDBG allocations and remove this responsibility from the city council and mayor's office.

We acknowledge that the deputy director overseeing the CDBG program administration, at the time of our audit, dedicated a great deal of his time and effort to correcting the City's CDBG program's administrative deficiencies. Since his taking responsibility for the CDBG program, redevelopment projects have not been CDBG funded, and the number of sub-recipients has decreased due to the establishment of a minimum sub-recipient amount of \$25,000, which should allow the City to administer the CDBG program more efficiently.

#### Objectives

We audited the City's CDBG program in response to a HUD Office of Inspector General (OIG) hotline complaint. Specifically, the complaint focused on unpaid loans issued to the City's Agency using CDBG funds. Our main objective was to address the citizen complaint and to determine whether the City administered its CDBG loans issued to the Agency in accordance with HUD rules and regulations.

## RESULTS OF AUDIT

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### Finding 1: The City Failed to Properly Administer CDBG Funds Provided to the Agency

The City failed to properly administer CDBG funds provided to the Agency in accordance with HUD requirements. We determined that more than \$1.8 million in CDBG cost was ineligible, \$5.1 million where the eligibility was questionable and unsupported, and an additional \$6 million was not adequately supported. The City failed to (1) execute interagency/interdepartment agreements; (2) list the projects in the action plan submitted to HUD or submit appropriate amendments; and (3) monitor the project activities to determine whether the costs were reasonable, allowable, allocable, and eligible. We attribute this condition to the City's failure to follow HUD requirements and the lack of proper policies and procedures. As a result, the City failed to ensure that nearly \$13 million in CDBG funds was used in compliance with program requirements to ensure appropriate benefit to low- and moderate-income persons.

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#### **Ineligible CDBG Redevelopment Project Costs**

The City failed to review CDBG costs to determine whether the costs were reasonable, allowable, allocable, and eligible. We reviewed all 35 of the City's CDBG loans originated between fiscal years 2000 and 2007 and determined that more than \$1.8 million was spent for ineligible purposes/activities on 9 projects<sup>2</sup>, including Central Imperial, Southcrest, and Crossroads activities. Each of the following items was recorded in HUD's Integrated Disbursement and Information System as "planning." Although 24 CFR 570.208(d)(4) states CDBG funds expended for planning costs under Sec. 570.205 and Sec. 570.206 will be considered as addressing the national objectives, we determined these costs were not for eligible planning activities.

- Project #1 (Central Imperial) - \$144,993 was used for acquisition and not for planning. Regulations at 24 CFR 570.205 state that eligible planning activities do not include project implementation costs. As an acquisition, it would also be ineligible due to the area's not being primarily residential.
- Project #7 (Central Imperial) – nearly \$1.3 million was also used for acquisition and not for planning.

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<sup>2</sup> In addition to the 9 projects being ineligible, they were also unsupported due to the lack of (1) agreements, (2) identification in the action plan/amendments, and (3) monitoring (see the Unsupported CDBG Redevelopment Project Costs section below).

- Project #9 (Central Imperial) - \$2,020 was not an allowable expense because engineering costs are not eligible planning expenses according to 24 CFR 570.205(a)(4)iii, nor was it an approved preaward cost under 24 CFR 570.200(h).
- Project #13 (Central Imperial) - \$5,064 in nonplanning costs was unallowable, since planning activities specifically exclude project implementation costs according to 24 CFR 570.205(a)(6)(5).
- Project #15 (Southcrest) - \$4,118 was for expenses incurred during a Southcrest Park Plaza commemoration festival, which is not a planning activity according to Office of Management and Budget (OMB) Circular A-87, attachment B-14. In addition, \$21,873 was for general government services, which is also not a planning activity and according to (OMB) Circular A-87, attachment B-19, is unallowable.
- Project #22 (Central Imperial) - \$67,002 was not used for planning but for general administration costs and not allowable under 24 CFR 570.205.
- Project #27 (Crossroads) - \$33,911 in reviewed costs was ineligible because the costs were not approved preaward costs according to 24 CFR 570.200(h).
- Project #29 (Crossroads) - \$1,200 in media/advertising costs was ineligible under OMB Circular A-87, attachment B(1)(f). The expense items were not geared to a specific project but to the City in general.
- Project #34 (Central Imperial) - \$235,578 in costs was not for eligible planning activities but for general administration, which is not allowed under 24 CFR 570.205.

### Eligibility of Central Imperial was Questionable

All expenditures related to the Central Imperial projects listed below, totaling \$5.1 million, were questionable under their recorded national objective of benefitting low- and moderate-income persons in an area. Regulations at 24 CFR [*Code of Federal Regulations*] 570.208(a)(1)(i) states that an activity that serves an area that is not primarily residential in character shall not qualify under this criterion. Based on information from the Southeastern Economic Development Corporation, the Central Imperial redevelopment project area is only 32 percent residential, which is not primarily residential. Insufficient supporting documentation was provided to demonstrate the projects met the national objective. Therefore, the total combined cost of more than \$5.1 million for these 10 projects must be supported or repaid.<sup>3</sup>

- Project #4 - \$145,000 used for public facilities and improvements
- Project #5 - \$275,207 used for public facilities and improvements
- Project #10 - \$93,625 used for commercial/industrial land acquisition/disposition

<sup>3</sup> In addition to the eligibility of the 10 Central Imperial projects being questionable, they were also unsupported due to the lack of (1) agreements, (2) identification in the action plan/amendments, and (3) monitoring (see the Unsupported CDBG Redevelopment Project Costs section below).

- Project #11 - \$717,264 used for other commercial/industrial improvements
- Project #12 - \$500,000 used for other commercial/industrial improvements
- Project #18 - \$352,000 used for other commercial/industrial improvements
- Project #24 - \$1.1 million used for commercial/industrial land acquisition/disposition
- Project #25 - \$502,042 used for other commercial/industrial improvements
- Project #28 - \$340,040 used for commercial/industrial infrastructure development
- Project #31 - \$1.1 million used for public facilities and improvements

### **Unsupported CDBG Redevelopment Project Costs**

The City failed to (1) execute interagency/interdepartment agreements, (2) list the projects in the action plan submitted to HUD or submit amendments to include the projects, and (3) monitor the project activities (including maintenance and review of CDBG exclusive project files to ensure eligibility) for all redevelopment projects utilizing CDBG funds. As a result, the remaining \$6 million in costs attributable to the 35 projects was unsupported (see appendix C for results by project).

### **Lack of Project Agreements with the Agency**

Since the Agency, the Centre City Development Corporation, and the Southeastern Economic Development Corporation were designated by the City's CDBG administration to undertake redevelopment activities assisted with CDBG funds, they are components (local public agencies) of the City government. Therefore, according to 24 CFR 570.501(a), as "public agencies/units of local government," they are subject to the same requirements as sub-recipients of grant funds.

Regulations at 24 CFR 570.503(a) and (b) state that a recipient shall sign a written agreement with the sub-recipient or public agency, as provided by 24 CFR 570.501(a), before disbursing any CDBG funds to a sub-recipient, and at a minimum, the written agreement shall include provisions on a statement of work, records and reports, program income, uniform administrative requirements, other program requirements, and suspension and termination clauses. However, the City improperly disbursed nearly \$13 million for all 35 redevelopment projects and recorded them as interest-bearing loans without executing an agreement containing the minimum project activity information required by HUD regulations. Without the required agreements, HUD could not determine the intended project scope, budget, and basis for assessing the City's grant administration performance.

During the course of our audit, the City's CDBG administrator informed us that the Agency's projects did not submit any type of application, agreement, or contract to the CDBG administration office.

These actions were usually initiated by city council approval of an Agency request to fund the loans. According to the program administrator, the direction that she had been given was that the City did not need to require an application because redevelopment projects were assumed, by prior management, to be eligible for CDBG funds.

### **Projects Not Listed in the Action Plan and Amendments Not Submitted**

The City failed to list the projects in the consolidated action plan submitted to HUD, and amendments were not recorded to include the projects as required. The action plan is a planning document required by HUD as an application for federal formula grant funds, listing and describing activities to be undertaken and a strategy for carrying out HUD programs to provide a basis for assessing performance. We reviewed the consolidated/action plans for fiscal years 2000 through 2007 to determine whether the projects in our sample of 35 Agency project activities were listed in the action plan and whether an amendment was submitted for those projects that were not listed in the action plan. The consolidated/action plans for fiscal years 2000 through 2007 did not list 34 of 35 projects<sup>4</sup> from our sample project activities selection. Most of the consolidated plans reviewed had a broad overview of the various redevelopment project areas within the City, but they did not list specific project activities funded by CDBG during those fiscal years.

In addition, none of the reviewed action plans contained amendments indicating that funding was available and allocated to any of the 35 projects/activities in our sample. We were told by HUD's Office of Community Planning and Development and the City's CDBG administration that action plan amendments were not submitted to HUD during our audit period. According to 24 CFR 91.505(a), the grantee shall amend the approved action plan whenever one of the following decisions is made: (1) to make a change in its allocation priorities or a change in the method of distribution of funds; (2) to carry out an activity, using funds from any program covered by the consolidated plan (including program income), not previously described in the action plan; or (3) to change the purpose, scope, location, or beneficiaries of an activity. All 35 reviewed projects/activities fell within at least one of those three categories as shown through the examples below.

- (1) To make a change in its allocation priorities or a change in the method of distribution of funds.

The amount of \$100,000 was reallocated from Council District 7 CDBG funds to the Crossroads project area survey. Agency and City resolutions specifically stated that the funds were for Agency and consultant staff costs and related expenses for the feasibility study of the Crossroads redevelopment survey area.

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<sup>4</sup> The only project listed in the action plan was project number 35, listed as Grantville redevelopment survey for fiscal year 2006, which did not receive CDBG funds.

The action plans for fiscal years 2001 and 2002 did not contain the Crossroads project activity above, and there was no subsequent amendment or notification sent to HUD.

- (2) To carry out an activity, using funds from any program covered by the consolidated plan (including program income), not previously described in the action plan.

Of the 35 reviewed projects, 34 fell under this category, since they all used CDBG funds, and were not previously described in the action plan, nor were amendments or notifications sent to HUD to include any of them after HUD's approval of the plan.

- (3) To change the purpose, scope, location, or beneficiaries of an activity.

City Resolution R-293165, dated May 30, 2000, authorized the reprogramming of \$90,000 previously allocated to public facilities – neighborhoods for the Wall of Excellence project, changing the beneficiary of the activity to Central Imperial - North Creek Site. The action plans for fiscal years 2000 and 2001 did not contain the Central Imperial project/activity above and there was no subsequent amendment or notification sent to HUD.

Since the City failed to include the projects in the consolidated/action plan and amendments were not submitted, HUD did not receive a description of the activities to be undertaken nor the strategy to be used for carrying out the CDBG program to provide a basis for assessing performance.

### **Monitoring Not Performed and CDBG Records Not Maintained**

The City failed to monitor the project activities and did not maintain CDBG exclusive files for any of the 35 projects, contrary to 24 CFR 85.40(a), which states that grantees must monitor grant- and subgrant-supported activities to ensure compliance with federal requirements and the achievement of performance goals. The City did not perform any type of project monitoring on any of the 35 reviewed projects, despite statements in the consolidated annual performance and evaluation reports to HUD that there was monitoring of CDBG activity.

### No Agreements or Monitoring Reports Prepared

Since the City failed to execute inter-agency/inter-department agreements (see above) with the Agency for all 35 reviewed redevelopment project activities, it did not have: a description of the work to be performed, a schedule for completing the work, and a CDBG budget for each project. According to 24 CFR 570.503(b), these items shall be in sufficient detail to provide a sound basis for the recipient to effectively monitor

performance under the agreement. The absence of project monitoring occurred because the City did not follow CDBG regulations to obtain the required information from the Agency before the disbursement of the CDBG funds in order to have a sound basis to monitor project/activity performance.

The City did not have any type of monitoring or progress reports for any of the reviewed redevelopment projects. The Agency's current deputy director stated that she had not seen any CDBG monitoring reports and did not know whether any existed. While working at the Centre City Development Corporation, she also did not see or create any CDBG monitoring reports. Without monitoring reports, HUD had no assurance that CDBG funds were used properly and in compliance with pertinent rules and regulations.

#### City Not Reviewing Costs for CDBG Eligibility and Lack of Centralized Records

Neither the City nor the Agency reviewed redevelopment costs for CDBG eligibility. In addition, the files and records related to the City's CDBG program were not maintained at one central location, and neither the City's CDBG administration nor the Agency maintained CDBG exclusive records for the redevelopment project areas.

The Agency's finance specialist stated that he was not aware of an eligibility process for loans administered by the City or the Agency and did not know what documentation would be required by HUD rules and regulations. The only documents that would be maintained with a particular project were the mayoral action or council action and the staff report stating the general purpose of the funding with little detail. The Agency was uncertain about all of the CDBG rules because CDBG is not an Agency program, and the Agency was more concerned with state redevelopment law. Although each project area had a project manager that kept working files, the files were not geared toward CDBG but toward redevelopment as a whole. According to the Agency's accountants, the Agency did not review costs submitted by project managers to see whether they were CDBG eligible, and the costs were not submitted to the City's CDBG program administration office.

The CDBG administrator added that one of the problems was that when redevelopment loans were approved and allocated by city council members and the Agency, they did not go through the City for eligibility or approval. As a result, there were no project files in the City's CDBG administration office. In addition, the current City accountant in charge of the reimbursements requested by the Agency did not get involved with HUD rules and regulations and strictly dealt with the accounting. The City's CDBG administration was disconnected from the redevelopment loans process, allowing the Agency to spend CDBG funds at will, while not following HUD requirements.

The CDBG redevelopment loans were administered so poorly that Southeastern Economic Development Corporation staff managing four redevelopment projects areas were not aware that most of the loans issued by the City were actually funded through the CDBG program.

## Conclusions

The City failed to properly administer its CDBG funds provided to the Agency in accordance with HUD requirements. The City did not comply with applicable HUD rules and regulations while disbursing CDBG funds to the Agency. Consequently, almost \$13 million was disbursed for ineligible and unsupported redevelopment project activities (see appendix D for administrative deficiencies by project). Proper monitoring and the enforcement of CDBG requirements were not possible without adequate interagency agreements between the City and the Agency. We attribute this deficiency to the City's weak management controls over compliance with HUD regulations. As a result, the City could not ensure that the Agency's redevelopment projects using CDBG funds were properly administered in compliance with pertinent HUD CDBG requirements or ensure maximum benefit to low-income residents.

## Recommendations

We recommend the Director of the Los Angeles Office of Community Planning and Development require the City to:

- 1A. Pay \$1,806,770 plus any applicable interest to HUD from nonfederal funds for CDBG project costs determined to be ineligible.
- 1B. Provide supporting documentation indicating that all CDBG program regulations were followed and national objectives were met for the redevelopment project activities determined to be questionable and/or unsupported or reimburse HUD \$11,183,193 from nonfederal funds.
- 1C. Execute written interagency agreements with the Agency for current projects and develop and implement procedures to ensure that future projects are included in the action plan or subsequent amendments in compliance with HUD requirements.
- 1D. Develop and implement written procedures and controls to ensure that the City and the Agency maintain adequate supporting documentation to show that CDBG program requirements are followed and national objectives are met for all current and future redevelopment projects.
- 1E. Develop and implement written procedures and controls to ensure that the City and the Agency adequately monitor CDBG activity for compliance with federal regulations.

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## Finding 2: The City Did Not Execute Loan Agreements and Failed to Ensure Repayment of Outstanding CDBG Loans

The City failed to execute loan agreements and make good faith efforts to collect payment on CDBG loans and the associated interest on these loans issued to the Agency. The Agency's outstanding debt from these loans was used to leverage/obtain state tax increment funds. This condition occurred due to the lack of controls over the City's CDBG program and because the City's focus was geared toward obtaining tax increment funds from the state in accordance with California redevelopment law and not the rules and regulations governing CDBG entitlement funds. As a result, the City did not maximize its CDBG community development activity and its use of the substantial monetary benefits that should have been derived from its \$139 million debt owed to the CDBG program.

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### **Tax Increment Process and Statement of Indebtedness**

Tax increments are authorized under Article XVI, section 16, of the California State Constitution and are regulated by California redevelopment law. Since 24 CFR 570.200(f) states that CDBG activities may be undertaken by one or more public agencies<sup>5</sup> through loans, subject to local law, state redevelopment law must be followed when distributing loans for the purpose of obtaining tax increments.

Tax increment is the primary source of revenue that redevelopment agencies have to undertake redevelopment projects. It is based on the premise that a revitalized project area will generate more property taxes than were produced in the area before redevelopment. Any increases in property value, as assessed because of change of ownership or new construction in the area, will increase tax revenue generated. This increase is the tax increment that goes to the Agency. Redevelopment agencies are entitled to collect the tax increment on the acreage they redeveloped to repay the debt involved in the project and to reinvest in redevelopment activities within the project area.

When a new redevelopment project is adopted, it typically has no revenue for the initial operating year. Until the redevelopment agency incurs debt, it is not entitled to receive tax increment revenue. However, entering into debt with no revenue stream for collateral is difficult. To resolve this dilemma, most redevelopment agencies with new project areas enter into loan or general services agreements with their city so as to immediately "create" debt. The amount of tax increments received is calculated using the statement of indebtedness, which is an annual certification of all outstanding debt of an agency.

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<sup>5</sup> Public agencies include the Agency, the Southeastern Economic Development Corporation (a nonprofit arm of the Agency), and the Centre City Development Corporation (a nonprofit arm of the Agency).

Each agency must annually certify the amount of outstanding debt in order for the state to determine how much tax increment funds an agency is entitled to in a given year. Generally, the more debt an agency has, the more tax increment funds will be received.

### **City Established and Certified CDBG Loans**

The City loaned CDBG funds to the Agency's redevelopment projects (see finding 1 for eligibility of their use). They were not supported by notes documenting the obligations; rather, the liabilities were authorized through City and Agency board resolutions identifying the instruments as loans to be repaid as funding became available and establishing an interest rate.<sup>6</sup>

We received the statements of indebtedness submitted to the state of California for fiscal years 2001 through 2008.<sup>7</sup> The outstanding balances for each of the CDBG loans were included in each statement, separated by project area. Each statement contained multiple certifications, one for each project area, certifying that all debt was included. The certifications reviewed were signed by the city comptroller, acting comptroller, or assistant city comptroller. According to California redevelopment law, Health and Safety Code, section 33765(h)(1), the statement of indebtedness constitutes prima facie evidence of the loans, advances, or indebtedness of the agency and, therefore, represents a legally binding document that the debt has been incurred and is owed. As a result, the CDBG instruments listed in each of these statements were loans, not grants or other type of financial assistance, and the purpose of the tax increments was to help pay these obligations.

In addition, the City's overall treatment of its loans to the Agency consistently identified them as actual debt of the Agency as evidenced by the:

- Inclusion of all outstanding CDBG debt in the Agency's annual audited financial statements for fiscal years 2003 to 2005.<sup>8</sup>
- Creation and maintenance of annual CDBG debt schedules by the City's Office of the Auditor and Comptroller to track the outstanding principal and interest balances, and
- Inclusion of the CDBG Loans in the annual City budget and recognition by the Office of the Independent Budget Analyst that the debt was outstanding and payable.

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<sup>6</sup> The basis for computation of interest on these loans is the "prime rate" as printed in the Wall Street Journal on the first Monday following January 1 of the calendar year in which the fiscal year begins plus 2 percent on the outstanding principal loan balance only.

<sup>7</sup> The fiscal year 2006 statement was not provided by the City.

<sup>8</sup> The financial audit statements for fiscal years 2006 and 2007 were past due at the time of our audit.

## **CDBG Funds Used for Leveraging/Obtaining Tax Increments**

The City and Agency recorded the CDBG loan funds as debt to increase their total liabilities and therefore, increase their ability to receive tax increment funding from the State of California. The Agency received well over \$500 million in tax increment funds between fiscal years 2000 and 2007. CDBG represented nearly 20 percent in the Agency's total debt<sup>9</sup> in fiscal year 2007, illustrating how instrumental CDBG debt has been in obtaining tax increment funds.

Debt payments were primarily only made so that the Agency could pass tax increment funds between an established project area and a separate project area that lacked tax increment funds or the ability to obtain secured financing. If the City received a payment from the Agency, it was usually applied to the accumulated interest balance so that the principal amount was not reduced, allowing interest to continually accumulate on the entire principal amount and, thus, maximize the amount of recorded debt. As a result, the City and the Agency were primarily using the CDBG funds to leverage/obtain tax increments from the state.

Leveraging is not listed as a CDBG-eligible activity and does not meet any of the three CDBG national objectives under 24 CFR Part 570. The purpose of CDBG loans' being used as a leveraging tool was verified through interviews with City officials. This activity was further evidenced through the City's concern with state redevelopment law and general failure to follow CDBG requirements (see finding 1). In addition, the City repeatedly indicated that it might waive the outstanding CDBG loans<sup>10</sup> and the associated program income due to the program once tax increment funding was exhausted for the project areas.

The City and its Agency used the CDBG program primarily to create debt with little regard for HUD rules and regulations. Leveraging of this sort without proper payment terms and an adequate eligibility process (see finding 1) is unacceptable, as it greatly diminishes the mission of the CDBG program by promoting leveraging/obtain tax increments over CDBG-eligible development activities.

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<sup>9</sup> The Agency held more than \$700 million in debt for fiscal year 2007, as certified to the state. Nearly 20 percent represents CDBG debt, with ratios of CDBG debt to total debt ranging from 1 to 89 percent for individual project areas.

<sup>10</sup> The City stated that it considered the CDBG loans to be subordinate to bonds and other secure financing.

## Lack of Repayment on Outstanding CDBG Loans

As of June 30, 2007, a total of 14 project areas and 2 survey areas had outstanding amounts on loans generated using CDBG funds, with an overall principal balance of more than \$63 million and an accumulated interest balance of more than \$76 million (see appendix C). In fiscal years 2006 and 2007, the City did not require or receive a single payment on the principal from the Agency for any of its outstanding CDBG loans. In addition, many long-outstanding loans had not received any payment. Since 1976, the City had distributed 236 CDBG loans to the Agency. Of the 236 loans, 212 (90 percent) remained outstanding, and 24 (10 percent) had been paid in full. Of the 212 outstanding loans, 209 (98.6 percent) had not received a payment on principal, and only three loans (1.4 percent of total outstanding) had received payments on principal, totaling \$926,148. The outstanding CDBG loans break down as follows:

- Eight loans originated in the 1970s had outstanding principal and interest balances of more than \$5.8 million and \$14 million, respectively.
- 55 loans originated in the 1980s had outstanding principal and interest balances of more than \$22.6 million and \$38.6 million, respectively.
- 108 loans originated in the 1990s had outstanding principal and interest balances of more than \$21.5 million and \$19.3 million, respectively.
- 41 loans originated in the 2000s had outstanding principal and interest balances of more than \$13 million and \$4 million, respectively.

The Central Imperial project area is one example in which the City failed to collect payment on outstanding CDBG loans (see appendix F). The CDBG loans for the Central Imperial project area, all originated between 1985 and 2005, accumulated large interest balances without a single payment on principal or interest. The CDBG debt represented 65 percent of all outstanding debt for the Central Imperial project area. The Central Imperial project area collected well over \$6 million dollars in tax increment funds between fiscal years 2000 and 2007.<sup>11</sup>

Regulations at 24 CFR 570.501(a) require the City to follow subrecipient rules and regulations, and 24 CFR 570.503 requires that agreements be executed before the disbursement of CDBG funds, including loan agreements. Therefore, the City and the Agency must take the steps necessary to create debt schedules, execute loan agreements, and begin making good faith efforts to pay down both principal and interest into the CDBG program income fund to be used for CDBG-eligible activities. We estimate that the expected annual amount that should be repaid is more than \$8.2 million.

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<sup>11</sup> The tax increment revenue is based on figures obtained through the statements of indebtedness for years 2001 through 2008, except for 2006, which was not provided by the City.

This amount represents an increase of more than \$7.2 million over the \$1 million average annual amount already repaid by the Agency between fiscal years 2000 and 2007 (see Scope and Methodology section and appendix A for computations).

## Conclusions

The City issued CDBG loans to the Agency as a mechanism to leverage/obtain state tax increment funds without executing loan agreements or making good faith efforts to repay the City's CDBG program funds to be used for other CDBG activities. Although the City received sporadic payments on some of the outstanding CDBG loans, most remained unpaid. The City's management focused on obtaining tax increment funds from the state and failed to follow CDBG requirements. As a result, the City recorded a large amount of continually increasing debt owed to the CDBG program that might not be returned, while receiving a substantial monetary benefit not subject to CDBG requirements, thereby providing no assurance that it used CDBG funds for their intended purpose or maximized its ability to carry out eligible community development activities. The City should develop and implement procedures and controls to ensure timely payments on CDBG loans to ensure receipt of CDBG program income.

## Recommendations

We recommend that the Director of the Los Angeles Office of Community Planning and Development require the City to

- 2A. Execute loan agreements between the City and its Agency indicating specific loan terms for repayment of the loans totaling \$139,201,997 (\$63,072,960 principal and \$76,129,037 interest), which would result in an estimated additional recovery of \$7,266,104 in CDBG program income over the first year.
- 2B. Develop written policies and procedures to ensure timely payments on CDBG loans of both principal and interest and that the resulting program income is appropriately recorded and used for eligible activities in accordance with HUD's requirements.

## SCOPE AND METHODOLOGY

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We performed our audit work at the City's offices located at 1200 3<sup>rd</sup> Avenue, Suite 1400, San Diego, California. Our review generally covered the period July 1, 2000, through June 30, 2007. We performed the audit work between April 3, 2007, and September 28, 2008.

To accomplish our audit objectives, we

- Reviewed the City's applicable internal controls;
- Reviewed relevant HUD regulations and OMB circulars;
- Reviewed the City's CDBG policies, procedures, and practices;
- Interacted with appropriate personnel of HUD's Office of Community Planning and Development Los Angeles field office and reviewed relevant HUD files and drawdown activity in HUD's Integrated Disbursement and Information System;
- Reviewed the City's consolidated action plans and consolidated annual performance and evaluation reports from fiscal years 2000 to 2007 as well as financial audit and single audit reports;
- Selected a nonstatistical sample of 35 projects from fiscal years 2000 to 2007, which included all CDBG loans funded within that period, and reviewed project city council resolutions, documents containing loan/reloan approvals, and related expenditure reports for each project;
- Reviewed and tested the City's records of selected projects to test whether (a) costs were eligible and adequately supported as required by HUD regulations and (b) the City and the Agency carried out these projects in accordance with HUD requirements;
- Interviewed key personnel from the City of San Diego, Redevelopment Agency, Southeastern Economic Development Corporation, and a former Centre City Development Corporation official
- Reviewed outstanding loans issued to the Redevelopment Agency by the City to identify and document interest and principal amounts for CDBG exclusive funded loans/reloans dating back to 1978
- Reviewed applicable California redevelopment law and statements of indebtedness certified by the City and submitted to obtain tax increment funds.

We examined City spreadsheets listing CDBG funded loans dating back to 1978 with an overall outstanding principal amount of \$63,072,960 and an accumulated interest totaling \$76,129,037. As of June 30, 2007, the City had used CDBG funds to reimburse the Agency's costs for 35 of 36 redevelopment project activities during the period from fiscal years 2000 through 2007. One activity was never funded (Grantville #35). We selected all of the project activities with the exception of one (Pacific Beach), originated and funded between fiscal years 2000 and 2007. We also reviewed the appropriations ledger for 34 of the 35 projects listing the resolution numbers for the allotment amounts, the direct payment voucher or transaction number for each individual expense, and the total amount expended.

From the appropriations ledger, we selected a nonstatistical sample of disbursement transactions for 34 project activities. We requested, obtained, and reviewed the supporting documentation provided by the Agency to determine whether the activity met one of the national objectives, the activity was a CDBG-eligible activity, and the reimbursed costs were eligible and reasonable. Sampled project expenditures included 16 Central Imperial project area activities (1, 4, 5, 7, 9, 10, 11, 12, 13, 18, 22, 24, 25, 28, 31, and 34), six Southcrest project area activities (14, 15, 17, 19, 23, and 26), three Crossroads project area activities (20, 27, and 29), one Marina/Centre City East District activity (3), one City Heights project area activity (6), and one North Park project activity (21). Due to the bulk of documentation provided by the City and overall lack of necessary support for the other sample items reviewed, we did not review the specific expenditures requested for the Grantville project area activities (30, 32, 33, and 35) and the Barrio Logan project area activities (2, 8, and 16).

We estimated funds to be put to better use attributable to the increase in Redevelopment Agency loan repayments was \$7.2 million (see appendix A). To determine the increase we compared the expected annual loan repayment to the average actual loan repayment.

We based the expected annual loan repayment on the average interest rate used by the City during our audit period. Between fiscal years 2000 and 2007, there were substantial fluctuations of the interest rate applied by the City to outstanding CDBG loan principal, ranging between six and 11 percent. Therefore, we applied the average interest rate of 8.34 percent, as it represents a reasonable estimate of potential future interest rates that may be applied. We used a standard payment model (using the rate, payment term, and present value) on the existing principal of \$63,072,960 and interest of \$76,129,037 (see appendix G). We estimated a 30-year loan term because it appeared to be a reasonable period for the repayment of long term debt (note that the City or HUD may choose different loan terms). Also, much of the debt has been outstanding for a number of years, some dating back to the 1970s. In addition, the City's October 9, 2008 budget analyst report estimated its time limit to receive tax increments to pay debt at between 2022 and 2050 depending on the project, with an average date of around 2039, about 30 years from now. No interest was applied to the existing interest balance as the City does not charge interest on accumulated interest balances. Altogether, we determined an expected annual CDBG loan payment of \$8,273,748.

We then reduced the expected annual loan repayment by the average actual loan repayment during our audit period, as we would expect the Agency to continue at that rate of payment if not for our audit. The actual average annual repayment between fiscal years 2000 and 2007 was \$1,003,894, including all payments of principal and interest (see appendix G). The difference between the expected annual loan repayment and the actual average loan repayment was therefore \$7,269,854. Our funds to be put to better use estimate was limited to one year of the anticipated recovery to remain conservative.

We performed our survey and audit fieldwork from January through September 2008 at the City's economic development offices in San Diego, California. We conducted our audit in accordance with generally accepted government auditing standards.

## **INTERNAL CONTROLS**

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Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

### **Relevant Internal Controls**

We determined the following internal controls were relevant to our audit objectives:

- Controls over program operations as they relate to the monitoring of CDBG activities and management of CDBG funds.
- Controls over the validity and reliability of data.
- Controls over compliance with laws and regulations.
- Controls over the safeguarding of resources as they relate to the disbursement of CDBG funds.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

### **Significant Weaknesses**

Based on our review, the following items are significant weaknesses:

- The City failed to properly administer its CDBG program when providing loans to its Agency (see finding 1).
- The City failed to execute loan agreements and make adequate attempts to receive payment on outstanding CDBG loans (see finding 2).

## APPENDIXES

### Appendix A

#### SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation number	Ineligible <u>1/</u>	Unsupported <u>2/</u>	Funds to be put to better use <u>3/</u>
1A	\$1,806,770		
1B		\$11,183,193	
2A			\$7,269,854
Total	\$1,806,770	\$11,183,193	\$7,269,854

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. For recommendation 2A, the \$7,269,854 in funds to be put to better use represents the estimated annual amount of combined principal and interest the Agency should pay to the CDBG fund to fully pay down the outstanding loan balance within a reasonable period, less the average amount being repaid by the City on the loans. More specifically, the annual repayment amount under a 30-year term with an interest rate of 8.34 percent (the City's average interest rate on the loans between 2000 and 2007) applied to the principal would be \$8,273,748. We have reduced this amount by the average annual amount that was repaid (\$1,003,894) to the fund over our audit period (fiscal years 2000 through 2007) to arrive at the \$7,269,854 in funds to be put to better use. To be conservative, we have limited the funds to be put to better use to the additional recovery of program income that would be received over a one-year period. See the Scope and Methodology section and Appendix G for additional details.

# Appendix B

## AUDITEE COMMENTS AND OIG'S EVALUATION

### Ref to OIG Evaluation

### Auditee Comments



THE CITY OF SAN DIEGO

December 8, 2008

Ms. Joan S. Hobbs  
Regional Inspector General of Audit Region IX, 9DGA  
U.S. Department of Housing and Urban Development  
Office of Inspector General  
611 West Sixth Street, Suite 1060  
Los Angeles, CA 90017-3101

Subject: Draft Audit Report for the City of San Diego

Dear Ms. Hobbs:

Thank you for your report dated November 17, 2008 detailing the recent audit of the City of San Diego's Community Development Block Grant (CDBG) Program relating to the City's Redevelopment Agency projects for the period fiscal years 2000 to 2007. The City is dedicated to administering all of our U.S. Department of Housing and Urban Development (HUD) funding programs in strict accordance with the HUD guidelines. We appreciate your comments and this letter provides the City's responses to the findings set forth in your report.

**1. General Comments on Draft Audit Report**

As you know, starting in fiscal year 2007, the Mayor launched major reforms in the City's CDBG Program and reassigned responsibilities to the Economic Development Division of the City Planning & Community Investment Department. We are in the midst of implementing these reforms, as identified by HUD's performance audit last year, to make the program more effective. The Mayor and City Council have already enacted some of these reforms, such as:

- Eliminated planning grants for sub-recipients;
- Implemented minimum sub-recipient grant amounts to \$25,000;
- Reduced number of sub-recipient applications from an average of 220 to 130;
- Reduced the number of sub-recipient agreements in FY 2008 to 98 from an average of 186 in the twelve prior years;
- Instituted mandatory workshops for sub-recipient applicants;
- Expanded mandatory workshops for sub-recipient grantees; and
- Implemented CBDO certification process.

Additional reforms will be presented to the City Council in 2009. The City sees the OIG audit as a valuable tool in this process of improving the City's CDBG Program.



DIVERSITY

**City Planning & Community Investment**  
1200 Third Avenue, Suite 1400 • San Diego, CA 92101  
Tel (619) 236-6700 Fax (619) 533-3219

**Comment 1**

As set forth in the November 17 draft OIG report, from fiscal year 2000 to 2007, the City failed to generate all the documentation required by HUD regulations for many of its CDBG loans/re-loans. Once we were made aware of this lack of documentation in the spring of 2007, we discontinued processing any Redevelopment re-loans and froze access to all Redevelopment draws for re-loans processed during three prior fiscal years.

**Comment 1**

While recognizing that the City and certain sub-recipients did not follow all applicable CDBG regulations for many of these projects, the City does believe that almost all of its CDBG expenditures in this time frame did go to projects which met one or more of the three HUD CDBG Program "national objectives" (i.e., benefiting low- and moderate-income persons, aiding in preventing or eliminating slums or blight, or addressing a need with a particular urgency because existing conditions pose a serious and immediate threat to the health and welfare of the community). Each of these projects was completed as intended, providing significant benefit to the community. The City's problems with documentation, while serious, reflect problems our current Mayor has addressed in numerous city programs since he took office in 2005. They do not reflect the lack of commitment to the goals of the CDBG Program. As set forth below, we respectfully request that OIG and HUD take the time to examine how the CDBG funds were used consistent with HUD's CDBG national objectives.

**2. Finding 1 - the City failed to properly administer CDBG funds provided to the Agency**  
(pages 6 and 7)

**Comment 2**

The report states that \$5,125,178 in CDBG expenditures from 10 different projects (Project #s 4, 5, 10, 11, 12, 18, 24, 25, 28 and 31) are ineligible based on the following reasoning: a) that the Central Imperial Redevelopment Project area in the Southeastern San Diego community is not primarily residential and b) that the expenditures were recorded under the national objective of benefiting low- and moderate-income persons in an area. Citing the 24 CFR 570.208(a)(1)(i) in support of the point that CDBG activities benefiting low- and moderate-income persons must take place in primarily residential areas, the OIG issued this ineligibility determination without any analysis of the actual area benefited by the 10 identified projects or the actual purpose of these 10 projects.

**Comment 3**

The City disagrees with the OIG's ineligibility determination for the 10 Central Imperial projects on two grounds: a) the OIG failed to properly apply 24 CFR 570.208 (a)(1) which does not require that the area benefited be "coterminous" with an officially recognized boundary (like the Central Imperial Redevelopment Project area used by the OIG) and b) many of these projects also met the national objective of eliminating slums, blight and deteriorating areas, and this national objective does not include the "primarily residential" requirement.

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**Comment 3**

Section 24 CFR 570.208(a)(1) defines the "primarily residential area" requirement as follows: "(S)uch an area need not be coterminous with census tracts or other officially recognized boundaries or other officially recognized boundaries, but must be the entire area served by the activity". As part of its \$5,125,178 ineligibility determination, the OIG's report fails to analyze and determine if the actual area served by the CDBG activity for each project is primarily residential or not. Instead, the report simply makes the blanket conclusion that any project within the Central Imperial Redevelopment Project area could not benefit a primarily residential area. Contrary to this conclusion, there are several low/moderate income neighborhoods in the Central Imperial area that benefited from the 10 projects.

**Comment 3**

Specifically, the City analyzed the six census tracts (30.01, 30.4, 31.11, 31.12, 31.03 and 141.02) encompassing the Central Imperial Redevelopment Project and the Southeastern Economic Development Corporation's (SEDC) Sphere of Influence. Because census data does not include information for nonresidential buildings, San Diego Association of Governments (SANDAG) land use designation data was applied to determine the residential/commercial percentages of the various land uses in the impacted project areas. The six census tracts surrounding the Central Imperial Redevelopment Project were found to be 74.57 % residential. The areas encompassed within SEDC's Sphere of Influence were further analyzed and the percentage of residential land uses in this study area was found to be 65.54 %. See Attachment 1.

**Comment 3**

As stated in the OIG's report, SEDC spent \$5,125,178 in the Central Imperial Redevelopment Project (an area that is home to primarily low- and moderate-income residents) for public facilities and improvements; land acquisition and disposition; and infrastructure development. Upon examination of the "entire area served by the activity" ( 24 CFR 570.208(a)(1)), these CDBG expenditures resulted in improvements benefitting the surrounding low- and moderate-income communities, not just the redevelopment project area. Naturally, those projects which benefited primarily residential areas within the Central Imperial Redevelopment Project are eligible under the CDBG program.

**Comment 4**

A redevelopment project area often is a subset of the broader community which it benefits. It may be selected to address obsolete infrastructure and conditions of blight in a focused geographic area, without formally identifying all of the neighboring residential areas that benefit from the CDBG activity. This is done in order to direct redevelopment activities on existing commercial parcels suitable for redevelopment with mixed-use, including new affordable housing and employment uses that benefit low- and moderate-income residents in adjacent communities, and to avoid concerns about applying eminent domain in existing residential neighborhoods.

**Comment 5**

Additionally, to the extent that any of the 10 Central Imperial projects are determined to not directly benefit low- and moderate-income residential areas (which we believe they do), these projects still met the CDBG program's second national objective to aid in the prevention or

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**Comment 5**

elimination of slums or blight. The CDBG national objective of supporting "activities which aid in the prevention or elimination of slums or blight" is defined in 24 CFR 570.208(b). To satisfy this CDBG criterion, the area benefited by the project is required to meet the definition of a slum, blighted, deteriorated or deteriorating area under State or local law. The Central Imperial Redevelopment Project meets the definition of blight under the California Health and Safety Code, Article 3 (Sections 33030 – 33039) Declaration of State Policy – Blighted Areas. Attachment 2 contains excerpts from a September 2003 report to the City Council for the Central Imperial Redevelopment Plan which documents the blighting conditions as well as objectives for alleviation of blight.

**Comment 2**

While the City understands and acknowledges that it should have done a better job of documenting both the national objectives associated with each project and how each project hopes to meet the applicable objective(s), we ask that the OIG and HUD focus attention on whether the subrecipient's actual use of CDBG funds satisfied a national objective before making an ineligibility determination.

**Comment 6**

Upon examination, each of the Central Imperial projects did meet the intent and the spirit of the CDBG program. The Central Imperial Redevelopment Project area in the Southeastern San Diego community is exactly the type of area that the CDBG program was intended to benefit: an area that is the home for low- and moderate-income residents, and an area suffering from blight and deteriorating residential, commercial and public facilities. Based on the express terms of the governing HUD regulations, the blight/deteriorating conditions found in Central Imperial and the data establishing the existence of low- and moderate-income neighborhoods within the Central Imperial area, we respectfully request that the OIG change the determination of ineligible to unsupported. Attachment 3 includes CDBG eligibility worksheets for 4 of the identified Central Imperial projects illustrating how the projects meet HUD guidelines.

**Comment 7**

**3. Ineligible CDBG redevelopment project costs – other ineligible project costs charged to CDBG (pages 7 and 8)**

The OIG recognized that planning costs spent in connection with CDBG programs are an eligible expenditure, but contended that certain projects spent funds for planning purposes that the OIG now contends are ineligible for project-specific reasons. As set forth below, the funds expended on these projects met national objectives and are eligible under the applicable HUD regulations.

Project #1 (Central Imperial): Under 24 CFR 570.201 and 24 CFR 570.208(d), the City may use CDBG funds to acquire property for any public purpose or if the planned use of the property meets a national objective or to combat blight or deteriorating conditions. Project #1 does so because the purpose for the acquisition was to eliminate a deteriorating condition. It is important to reemphasize here, as stated above, that the projects listed herein relating to Central Imperial (Project #s 1, 4, 5, 7, 9, 10, 11, 12, 13, 18, 24, 25, 28 and 31) were all part of a larger effort with

**Comment 7**

the underlying intent to provide public assistance to convert unproductive land to viable urban uses, serve many of the unmet commercial and retail needs of the community, rehabilitate, construct and preserve low- and moderate-income housing stock and create a variety of employment opportunities. For additional information on the employment opportunities generated from redevelopment activities in this area, SEDC produces quarterly employment reports for their project areas. Reports from fiscal year 2003 to the present can be made available upon request.

**Comment 7**

**Project #7 (Central Imperial):** Under 24 CFR 570.201 and 24 CFR 570.208(d), the City may use CDBG funds to acquire property for any public purpose or if the planned use of the property meets a national objective or to combat blight or deteriorating conditions. Project #7 which is also identified as the Market Creek project does so because the purpose for the acquisition was to eliminate a deteriorating condition.

**Comment 8**

**Project #22 and # 34 (Central Imperial):** The City simply mis-classified these costs as "planning costs"; however, general administrative costs are eligible and recoverable under 24 CFR 570.206.

**Comment 1**

**4. Lack of project agreements with the Agency (page 8)**

As set forth in the OIG report, the City has now undertaken reforms to implement the proper CDBG procedures including drafting written interagency agreements for future projects. These reforms were initiated in the summer of 2007 as soon as the City learned that past interagency agreements did not follow proper CDBG procedures.

**Comment 1**

**5. Projects not listed in the Action Plan and amendments not submitted (pages 9 and 10)**

As set forth in the OIG report, corrective action has been implemented to ensure ongoing and future compliance.

**Comment 1**

**6. Monitoring not performed and CDBG records not maintained (pages 10 and 11)**

As set forth in the OIG report, corrective actions have been implemented to comply with and ensure monitoring and record retention.

**7. Finding 2 - the City did not execute loan agreements and failed to ensure repayment of outstanding CDBG loans; tax increment process and statement of indebtedness; City established and certified CDBG loans; CDBG funds used for leveraging; and lack of repayment on outstanding CDBG loans (pages 13 to 17)**

Consistent with the national objectives of the CDBG program and California Law, the Agency established redevelopment project areas to alleviate blight, provide adequate public

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improvements, improve deteriorating physical conditions and create affordable housing for low- and moderate-income residential areas. Such communities are typically older neighborhoods, low- and moderate-income areas, blighted or deteriorating commercial areas, and/or commercial areas serving CDBG-eligible census tracts. California Redevelopment Law defines the conditions of blight that must be present for a project area to be established. Indisputably, the formation of such project areas based upon a proper finding under California Redevelopment Law, associated blight alleviation and production of affordable housing requires capital investment, typically seeded by the local jurisdictions and governmental programs.

The City, as many cities across California, historically has utilized CDBG and general fund dollars to revitalize and redevelop these projects areas. As HUD has recognized through the CDBG program, making public funds available on the front end of the redevelopment effort are critical in the early years of a revitalization program. Funding of strategic, catalytic projects spawn new housing opportunities, eliminate blight and result in private investment generating increased tax increment revenues. Increased tax increment revenues are reinvested into the same communities to continue and sustain viable neighborhoods. The importance of the use of CDBG and general fund monies in the early years of a long-range revitalization effort is recognized as a valuable and necessary tool for success. A City and Agency goal has been to reinstate these funding sources as project areas prosper, and adequate tax increment becomes available to "repay" these funding sources. Ultimately this will enhance the overall objectives of the CDBG program.

**Comment 9**

The early year expenditures of CDBG funds were for CDBG eligible activities and came through the City's CDBG process. The funds were not allocated to project areas for the "purpose" of leveraging, though they were included in the Agency's Statement of Indebtedness. These funds financed important activities meeting both CDBG and redevelopment goals and objectives.

Stagnant or declining property values because of blighted conditions are typical in areas prior to formation of a redevelopment plan and project area. These once vibrant areas suffer from blight, lack of job opportunities, lack of infrastructure and open space, increased crime, and concentration of low-income households within the community living in poor housing conditions.

**Comment 10**

To help pay back the funds used to address these conditions, a redevelopment agency receives of portion of the "increase" in property tax revenue over time. However, there is no property tax increment available for redevelopment purposes until property values, area conditions and investment begin to improve property values. Public funds are necessary to seed the revitalization effort. The CDBG program is an essential contributor to this effort. The CDBG program shares goals and objectives with California redevelopment agencies. CDBG funds implement eligible activities to help rebuild the community.

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**Comment 11**

The success and rate of increase in tax increment revenue and the ability to repay the CDBG loan varies project area by project area. Some project areas take decades of investment before revenue is available to repay initial seed money. San Diego's 17 redevelopment project areas vary greatly in the need for infrastructure and capital costs. The repayment of loans on a schedule without regard to the tax increment status of each project area runs counter to the goals of the CDBG program: to benefit low- and moderate-income persons and to eliminate slums, blight and other deteriorating conditions. A successful revitalization strategy must take into account current project area revenues, as public improvements and affordable housing take effect to reverse the former downward trends. Redevelopment project areas generally have a 30 year life for implementation plus an additional 10 years to repay any indebtedness then outstanding. The later ten years is when a Agency does not implement project activities and uses all of its tax increment received to pay down any indebtedness.

**Comment 12**

The implementation strategies and financial strength of each project area need to be thoroughly examined to determine an appropriate repayment plan so that each affected redevelopment project area can manage the cash flow. Loan agreement repayment terms, especially as to timing are critical to ensure that the investments of CDBG and tax increment revenues will not be lost by forcing repayment on a schedule that will harm the forward movement of the revitalization effort, which would be detrimental to the low- and moderate-income communities, and efforts to remediate blight, which CDBG and California Redevelopment were created to address.

**Comment 9**

In summary, the OIG report does not acknowledge these critical strategies and concludes that "leveraging is not listed as a CDBG-eligible activity and does not meet any of the three CDBG national objectives under 24 CFR Part 570." The City disagrees that the funds were "leveraged" simply to receive tax increment. Rather, the funds were utilized to initiate redevelopment and eliminate blight where other funding sources were simply not available. While leveraging of Tax Increment revenue would occur in instances where the CDBG loans create conditions for project areas to receive more tax increment in a given year than they would otherwise receive, analysis of the Agency's statements of indebtedness and tax increment receipts for fiscal year 2007 reveal that only 1.04% of tax increment received in that year can be attributable to CDBG debt. That is not to say that CDBG funds have not contributed to tax increment receipts, rather that the role of CDBG is marginal and not primary to tax increment receipts.

**Comment 13**

**Comment 14**

In any case, the City does not concur that leveraging of CDBG should be portrayed as a negative activity. Rather, to the extent that CDBG debt increases the tax increment received by the Agency, the aggregate amount of funds available for investment in blight removal and low- and moderate-income housing is increased.

**8. Recommendation 2A: Execute loan agreements between the City and its Agency indicating specific loan terms for repayment of the loans (page 17)**

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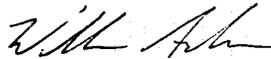
The City will execute loan agreements between the City and the Redevelopment Agency indicating specific loan terms for repayment of the loans. We respectfully request that the OIG give the City the opportunity to work with HUD on the terms of the repayment.

**9. Recommendation 2B: Develop written policies and procedures to ensure timely payments on CDBG loans of both principal and interest and that the resulting program income is appropriately recorded and used for eligible activities in accordance with HUD's requirements (page 17)**

The City will develop written policies and procedures to ensure timely payments on CDBG loans of both principal and interest and that the resulting program income is appropriately recorded and used for eligible activities in accordance with HUD's requirements.

In closing, the City has taken this audit very seriously and appreciates the opportunity to provide comments to the OIG report. We are committed to continuing CDBG Program reforms to ensure that the City is in full compliance with HUD guidelines. If additional information is needed, please contact Beth Murray, Deputy Director of Economic Development at (619) 236-6421 or [Bmurray@sandiego.gov](mailto:Bmurray@sandiego.gov).

Sincerely,



William Anderson, FAICP, Director  
City Planning & Community Investment Department

Cc: Jay Goldstone, Chief Operating Officer  
Mary Lewis, Chief Financial Officer

Attachments:

1. Analysis of Land Uses in Central Imperial
2. Excerpts from September 2003 Report to City Council for the Central Imperial Redevelopment Plan
3. CDBG Application forms for Project #s 10, 11, 24 and 31

### Central Imperial Land use Analysis

A land use analyses was conducted for census tracts 30.01, 30.4, 31.11, 31.12, 141.02 in the Central Imperial area of Southeastern San Diego. Using San Diego Association of Governments (SANDAG) land use designations as an overlay to the census tracts we were able to obtain the acreage amount of each land use category. The analysis was conducted for the census tracts and as well as for Southeast Economic Development Corporation's (SEDC) Sphere of Influence

Central Imperial Land Use Areas by Census Tracts (in acres)

Land Use	Census Tract 30.01	Census Tract 30.04	Census Tract 31.03	Census Tract 31.11	Census Tract 31.12	Census Tract 141.02	Total Area	% of Land Use
Comm. Emp., Retail, & Services	196,086	188,519	251,062	63,622	652,817	277,652	1,629,758	1.54%
Industrial Employment	468,005			257,195		357	725,557	0.69%
Inst., Public and Semi-Public	981,350	755,672	725,383	959,832	2,038,533	522,647	5,983,416	5.66%
Park, Open Space, & Recreation	6,808,811	605,739	1,995,882	391,634	361,191	290,098	10,453,356	9.89%
Residential	13,342,861	11,661,468	17,783,701	12,039,898	12,283,435	11,695,768	78,807,131	74.57%
Roads / Freeways / Transportation	980,803	138,500	-	3,862	-	4,421	1,127,586	1.07%
Vacant	2,476,602	336,542	1,192,543	1,872,543	837,869	243,736	6,959,834	6.59%
<b>Total</b>	<b>25,254,519</b>	<b>13,686,440</b>	<b>21,948,571</b>	<b>15,588,587</b>	<b>16,173,844</b>	<b>13,034,679</b>	<b>105,686,639</b>	<b>100.00%</b>

Central Imperial Land Use Areas in (SEDC) Sphere of Influence (in acres)

Land Use	Census Tract 30.01	Census Tract 30.04	Census Tract 31.03	Census Tract 31.11	Census Tract 31.12	Census Tract 141.02	Total Area	% of Land Use
Comm., Emp., Retail, & Services	142,893	188,519	177,079	58,827	652,817	140,896	1,361,030	6.25%
Industrial Employment	468,005	-	-	257,195	-	-	725,200	3.33%
Inst., Public and Semi-Public	268,400	75,163	148,610	186,977	347,739	-	1,026,890	4.72%
Park, Open Space, & Recreation	1,145,348	6,666	348,023	147,510	138,642	-	1,786,189	8.20%
Residential	806,062	5,763,508	471,753	4,468,835	2,733,762	28,160	14,272,079	65.54%
Roads / Freeways / Transportation	111,538	138,500	-	3,862	-	-	253,900	1.17%
Vacant	519,447	249,026	19,805	1,028,877	532,173	-	2,349,328	10.79%
<b>Total</b>	<b>3,461,694</b>	<b>6,421,382</b>	<b>1,165,270</b>	<b>6,152,082</b>	<b>4,405,133</b>	<b>169,056</b>	<b>21,774,616</b>	<b>100.00%</b>

Comment 2  
and  
Comment 3



Report to the City Council for the  
Fourth Amendment to the Redevelopment Plan for the Central Imperial  
Redevelopment Project

*Prepared for*  
The Redevelopment Agency of the City of San Diego  
600 B Street, Suite 400  
San Diego, CA 92101

*Prepared by*  
Southeastern Economic Development Corporation  
995 Gateway Center Way, Suite 300  
San Diego, CA 92102

*Fiscal Consultant*  
Keyser Marston Associates, Inc.  
1600 Hotel Circle North, Suite 716  
San Diego, CA 92108

SEPTEMBER 2003



**C. OBJECTIVES FOR ALLEVIATION OF BLIGHT**

In 1981, in response to the needs of the community, the Agency formed SEDC, which is charged with the objective of stimulating investment and long-term development in the area by implementing redevelopment efforts in Southeastern San Diego on behalf of the Agency. These efforts are part of and are coordinated with the goals, objectives and needs identified in the Southeast San Diego Community Plan as adopted in 1987 by the City Council.

The Central Imperial Redevelopment Plan is one of several redevelopment plans adopted in Southeastern San Diego. The Existing Plan recognizes the unique public and private investment opportunities created by the light rail system and the opportunities to address community needs by focusing redevelopment efforts along the light rail system and major commercial streets. As identified in the Existing Plan and the Implementation Plan for the Project Area, the specific objectives of the Project include:

- Promote revitalization of the neighborhood within the Central Imperial Project Area.
- Provide incentives for the development of new commercial and residential facilities to better serve the community and to upgrade the physical appearances of commercial and residential areas within the Project.
- Provide incentives for development of underutilized parcels of land in the Project Area.
- Maintain the existing residential character of the Project Area.
- Ensure maximum opportunity for employment of local residents in permanent jobs created by new business development and in temporary residential and business construction jobs.
- Ensure that local people have the opportunity to establish new businesses or expand existing businesses in new commercial facilities, and are provided information on technical and financial programs offered by various organizations including the SEDC Business Development Program.
- Support efforts to communicate and publicize to all businesses and residents current information on community revitalization efforts.

The following key objectives have been identified for revitalization of the Project Area:

- Development of underutilized parcels of land.
- Development of new commercial facilities to serve the community.
- Establishment of new businesses in new commercial facilities.
- Provide sites and development opportunities that will increase the economic base and employment prospects for the community.
- Development of a range of housing types and home ownership opportunities.

The goals and objectives identified for the Project Area in the Southeast San Diego Community Plan are quite similar to the above goals and objectives. Specific objectives identified for the Central Imperial Redevelopment Project in the Community Plan include:

- Attract a large regional supermarket chain outlet to the area.
- Rehabilitate the intersection of Market Street and Euclid Avenue.
- Develop a quality residential project in the Cal Trans owned 157 Expressway.
- Continue and expand housing rehabilitation as necessary.

As explained in Section II of this Report, the primary proposed Amendment is to extend the Agency's eminent domain authority in the Project Area, which is currently set to expire in September 2004. Although the Agency currently has no immediate plans to use eminent domain within the Project Area, its availability for use may be critical to implement the specific objectives of the Existing Plan as outlined above along with the Agency's proposed projects and programs.

Some of the Agency's proposed projects include assistance with the development of residential housing within the Project Area, including housing for very low, low and moderate income persons and families. Furthermore, the Southeastern San Diego area continues to lack commercial facilities. Currently, there are four shopping centers in the area, one on National Avenue near Interstate 15 and anchored by a major drugstore, Southcrest area at 43<sup>rd</sup> and Alpha Streets and anchored by a Albertson's, two in the Central Imperial Project Area, Imperial Marketplace anchored by a Home Depot, and Market Creek Plaza anchored by a Food-4-Less. A general merchandise outlet consisting of a Costco is located on Gateway Center Drive. A 1995 study estimated that

**Comment 5**

**III. OVERVIEW OF BLIGHTING CONDITIONS WITHIN THE PROJECT AREA**

**A. BLIGHTING CONDITIONS**

The Project Area has long suffered from a loss of private investment and development activity, due in large part to deteriorating physical and economic conditions, including crime. The Agency's Report to the City Council for the Central Imperial Redevelopment Project (SEDC, 1992), the Report to the City Council for the Second Amendment to the Central Imperial Redevelopment Plan (SEDC, 1996), and the Report to the City Council for the Third Amendment to the Central Imperial Redevelopment Plan (SEDC, 2000) presented detailed assessments of blighting conditions in the Project Area at the time of plan adoption and at the time of the Second and Third Amendment. All of the reports documented extensive blighting conditions in the Project Area, including both physical deterioration and economic dislocation. The following blighting influences were identified:

- High crime rate/lack of public safety.
- High vacancies in commercial structures.
- A large percentage of deteriorated and dilapidated structures, especially aging and obsolete commercial buildings.
- Inadequate public improvements, facilities, and utilities.
- Inferior circulation.
- Lack of adequate shopping facilities.
- Business migration out of Project Area.
- High unemployment rate.
- Lack of affordable housing options.
- Residential overcrowding.
- Depreciated or stagnant property values or impaired investment.
- Irregular topography.
- Parcels of inadequate size and irregular shape and in multiple ownership.
- Areas prone to flooding.
- Excessive vacant and underutilized lots.

**B. OBJECTIVES AND ACTIONS NECESSARY FOR ALLEVIATION OF BLIGHT**

The Existing Plan identified the following key objectives for revitalization of the Project Area:

- Development of a range of housing types and home ownership opportunities.
- Development of underutilized parcels of land.
- Development of new commercial facilities to serve the community.

- Establishment of new businesses in new commercial facilities.
- Provision of sites and development opportunities that will increase the economic base and employment prospects for the community.

The specific actions necessary to achieve the above objectives included:

- Installation of public improvements in order to entice private investors to invest and build in the area.
- Provision of financial assistance for rehabilitation and conservation of structures.
- Demolition and relocation, as necessary, buildings suffering from deterioration and dilapidation, age and obsolescence, and defective design and character of physical construction.
- Assistance with site assembly, preparation, and relocation to encourage the private sector to remediate problems such as inappropriate mixed and shifting uses, and small and irregular parcels.

**C. NECESSITY FOR EXTENSION OF EMINENT DOMAIN AUTHORITY**

Since some of the original blighting conditions identified in the Project Area still exist, it may be necessary for the Agency to use their eminent domain authority in order to implement the objectives and actions necessary for alleviation of blight as described above.

**City of San Diego  
Community and Economic Development Department  
Community Development Block Grant (CDBG) Administration**

**CDBG Eligibility Worksheet**

The purpose of this form is to demonstrate eligibility for CDBG funds for the project named below. Please complete the form in its entirety and return to Shirley Reid at [sreid@sandiego.gov](mailto:sreid@sandiego.gov).

Comment 6

**Project Management Assignment**

Department/Agency*:		Southeastern Economic Development Corporation (SEDC)		
Project Administrator:	N/A	Phone:	619-527-7345	
Mailing Address:	4393 Imperial Avenue, # 200		MS#	
E-Mail Address:	N/A			
Notes:				
*Abbreviations:	County – County of San Diego	SDHC – San Diego Housing Commission	CS – Community Services Division	OSB – Office of Small Business
	City – City of San Diego	E&CP – Engineering & Capital Projects	SS – Social Services	Dev. Services – Development Services

**Project Details**

(1) Fiscal Year:	2001		
(2) Project Title:	#10, Central Imperial Project		
(3) National Objective (See Table 1):	Slum Blight Area		
(4) Eligible Activity (See Table 2):	Acquisition	Eligible Activity	01 HUD Matrix Code
(5) Project Description:	This project will develop a community commercial center for retail space including a multiplex movie theater, home improvement center, and other retail uses. The project will require flood control improvements to South Las Chollas Creek. These flood control improvements will require the acquisition of forty-seven properties.		
(6) Location of Activity:	30.01, 30.04, 31.11, 31.12, 31.03, 141.02	San Diego	92113-
	Street	City	Zip Code

**Prepared By**

CDBG	N/A	
Name	Title	Date

**CDBG PERSONNEL USE ONLY**

Eligible Project	Y	Reason Ineligible	N/A
CDBG Funds Allocated (via council action):		AMRIS Accounting:	N/A / / /
			Fund/Dept/Org/Job Order

**City of San Diego  
Community and Economic Development Department  
Community Development Block Grant (CDBG) Administration**

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Comment 6

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Department/Agency*:	Southeastern Economic Development Corporation (SEDC)		
Project Administrator:	N/A	Phone:	619-527-7345
Mailing Address:	4393 Imperial Avenue, # 200		MS#
E-Mail Address:	N/A		
Notes:			
*Abbreviations:	County - County of San Diego City - City of San Diego	SDHC - San Diego Housing Commission E&CP - Engineering & Capital Projects	CS - Community Services Division SS - Social Services
			OSB - Office of Small Business Dev. Services - Development Services

**Project Details**

(1) Fiscal Year:	2001	
(2) Project Title:	#11 & 31, Central Imperial Project	
(3) National Objective (See Table 1):	Slum Blight Area	
(4) Eligible Activity (See Table 2):	Public Facilities & Improvements	03
	Eligible Activity	HUD Matrix Code
(5) Project Description:	This project will provide a 35,000 square feet expansion to the Southeast Medical Center located at 286 Euclid Avenue in southeastern San Diego. The expansion will house much needed primary and specialty care services as well as kidney dialysis services for the most medically underserved area in the Southeastern region. The 35,000 square feet building expansion is much needed to improve the health status of Southeast San Diego residents.	
(6) Location of Activity:	30.01, 30.04, 31.11, 31.12, 31.03, 141.02	San Diego
	Street	City
		92113-
		Zip Code

**Prepared By**

CDBG Office	N/A	
Name	Title	Date

**CDBG PERSONNEL USE ONLY**

Eligible Project	Y	Reason Ineligible	N/A
CDBG Funds Allocated (via council action):		AMRIS Accounting:	N/A / / /
			Fund/Dept/Org/Job Order

**City of San Diego  
Community and Economic Development Department  
Community Development Block Grant (CDBG) Administration**

**CDBG Eligibility Worksheet**

The purpose of this form is to demonstrate eligibility for CDBG funds for the project named below. Please complete the form in its entirety and return to Shirley Reid at [sreid@sandiego.gov](mailto:sreid@sandiego.gov).

Comment 6

**Project Management Assignment**

Department/Agency*:	Southeastern Economic Development Corporation (SEDC)			
Project Administrator:	N/A	Phone:	619-527-7345	
Mailing Address:	4393 Imperial Ave, # 200	MS#		
E-Mail Address:	N/A			
Notes:				
*Abbreviations:	County – County of San Diego	SDHC – San Diego Housing Commission	CS – Community Services Division	OSB – Office of Small Business
	City – City of San Diego	E&CP – Engineering & Capital Projects	SS – Social Services	Dev. Services – Development Services

**Project Details**

(1) Fiscal Year:	2003			
(2) Project Title:	#24, Central Imperial - Industrial Site Acquisition			
(3) National Objective (See Table 1):	Slum Blight Area			
(4) Eligible Activity (See Table 2):	Acquisition	Eligible Activity	01	HUD Matrix Code
(5) Project Description:	<p>This project consists of acquiring and developing land. The land development consists of subdividing the 14.7 acre site into six industrial lots, including a site for the Encanto Post Office. This property will provide additional opportunities for industrial development on property that is currently economically blighted.</p> <p>This project created 69 new jobs for residents within the community.</p>			
(6) Location of Activity:	30.01, 30.04, 31.11, 31.12, 31.03, 141.02	San Diego	92113-	
	Street	City	Zip Code	

**Prepared By**

CDBG Office	N/A	
Name	Title	Date

**CDBG PERSONNEL USE ONLY**

Eligible Project	Y	Reason Ineligible	N/A
CDBG Funds Allocated (via council action):		AMRIS Accounting:	N/A/ / /
			Fund/Dept/Org/Job Order

## **OIG Evaluation of Auditee Comments**

**Comment 1** The City agreed that it has not been complying with program requirements and stated that the Mayor and the City Council have enacted some major reforms in the City's CDBG program. Although we acknowledge that the City is taking steps to address its problems with the program, none of the listed reforms address the issues that we found with regard to the Redevelopment Agency projects.

The City also indicated that all the redevelopment projects were completed as intended and believes that almost all its CDBG expenditures went to projects that met one or more of the CDBG national objectives. However, there was insufficient documentation available to show this was the case. According to 24 CFR 570.501(b), the recipient is responsible for ensuring that CDBG funds are used in accordance with all program requirements.

**Comment 2** We provided the City numerous opportunities to provide supporting documentation, and issued a demand letter on June 6, 2008 to obtain all relevant documentation. We conducted a complete and thorough analysis of the support provided by the City. The City did not provide any documentation detailing the area served by the Central Imperial redevelopment project area, nor did City officials mention it until the exit conference. In fact, the documents provided by the City for the Central Imperial projects failed to even mention the specific projects being funded by CDBG funds within the Central Imperial redevelopment area. In two interviews with high ranking City and Southeastern Economic Development Corporation employees, we were told that CDBG funds spent in Central Imperial amounted to a waste of funds and were not assisting low/mod persons.

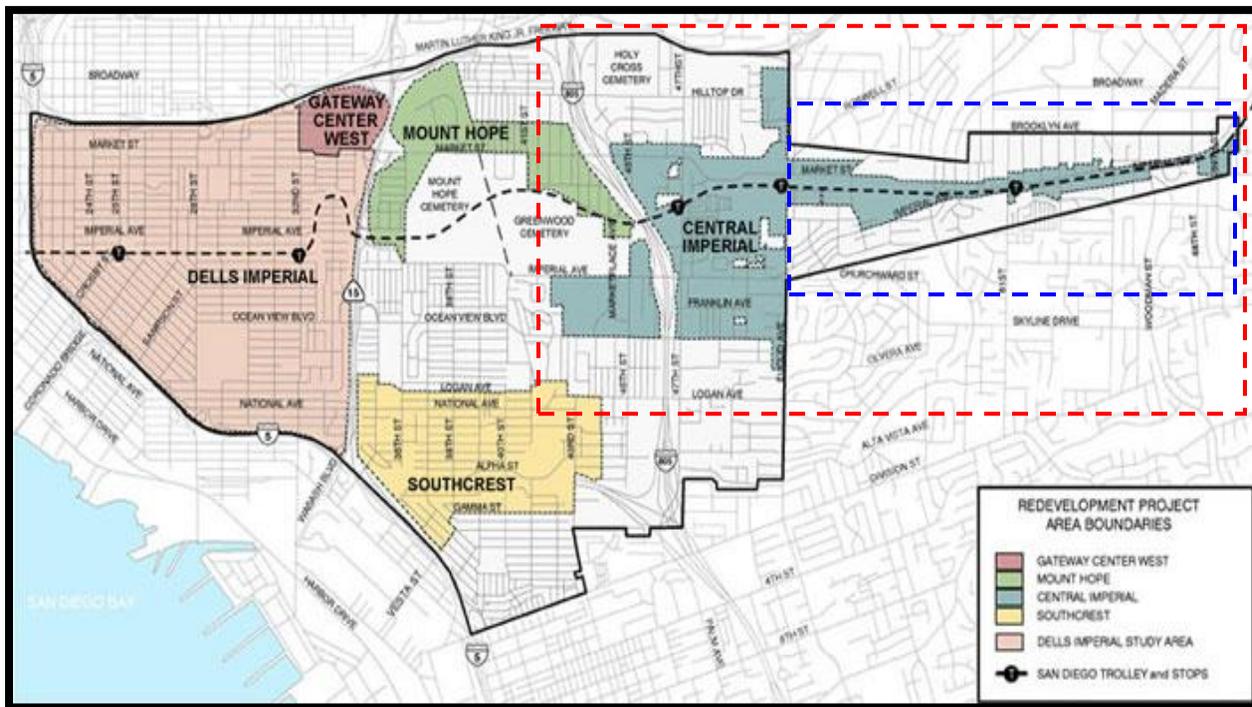
Due to the lack of City controls, the Redevelopment Agency was able to use the CDBG funds as a spending account to pay various unsupported costs with no clear indication the activity was for the CDBG program. 24 CFR 570 has specific rules in place to prevent CDBG from becoming a spending account. Agreements, monitoring, and reviews must be in place and completed in an orderly and timely fashion to ensure that CDBG funds are spent according to HUD rules and regulations. However, the City did not complete any of the steps required by HUD. Our review and analysis cannot be based on assumptions of the area served, but on facts and the documents provided. Given only the documents provided during our review, we made an ineligibility determination.

However, given the City's current claims that it can demonstrate it met the national objective by showing the area served was residential, we have modified the report to reclassify the Central Imperial project costs from ineligible to unsupported, as we agreed to consider at our exit conference with City officials.

[Note: this has resulted in our removing \$5.1 million in ineligible costs from recommendation 1A, eliminating recommendation 1B of the draft report, and renumbering the subsequent finding 1 recommendations].

**Comment 3** We agree that 24 CFR 570.208(a)(1) does not require that the area benefitted be coterminous with an officially recognized boundary. However, the officially recognized boundary, the Central Imperial redevelopment project area, was the only boundary detailed by the City during our audit. The Central Imperial redevelopment project area is not primarily residential, a fact not disputed by the City.

We examined the map provided by the City in their response detailing the area served in relation to the Central Imperial redevelopment project area (see picture below). However, the map provided by the City only details a portion of the Central Imperial redevelopment project area (area outlined in blue) and the Southeastern Economic Development Corporation’s sphere of influence (area outlined in black). The area filled in blue (also outlined in red) is the entire Central Imperial redevelopment project area and the area reviewed in our audit.



The Central Imperial map and land use analysis provided by the City are not sufficient to fully support the areas served by the Central Imperial projects (note that the land use analysis was not provided during the course of field work and was recently conducted to retroactively qualify projects). The City must submit thorough and complete documents, satisfying all applicable regulations, to HUD indicating eligibility for each individual project (national objective and activity), project scope, budget, and expenditures.

**Comment 4** While California Redevelopment Law may allow for a city to not include the area served, regulations at 24 CFR 570.208(a)(1) and 24 CFR 570.506 requires the area served to be defined and documented. The City's response further emphasizes our conclusion that more consideration has been given to California Redevelopment Law than to meeting HUD CDBG requirements.

**Comment 5** Central Imperial projects were qualified under the national objective of assisting low/mod persons in a specific area through the activity of special economic development. Documents required by not provided during our audit include:

- 24 CFR 570.208(a)(1) – area is primarily residential
- 24 CFR 570.209(b) – evidence that a minimum level of public benefit was obtained;
- 24 CFR 570.506 – boundaries of the service area, income characteristics of families and unrelated individuals in the service area;

The City has conceded it did not prequalify any of its projects as required by 24 CFR 570.200. As to meeting the national objective of eliminating slum/blight, the City would have to show that it adhered to regulations at 24 CFR 570.208(c) and 24 CFR 570.506(b)(8), not the California redevelopment standards. The attachment provided by the City was insufficient to show this was the case. In addition, if the City cannot show that it met the national objective originally submitted to HUD, it would be inappropriate to retroactively apply a new objective, as this is required to be performed at the outset of each project before funds were spent.

**Comment 6** As discussed in comments 1 through 3 above, we have adjusted the report to reclassify the Central Imperial projects from ineligible to unsupported. However, the worksheets provided in the City's response (shown on pages 37 through 39 of this report) were created in response to our audit and not the original documentation provided by the City. The practice of creating support after funds are spent is inappropriate. As a result, we find the retroactive worksheets insufficient and unacceptable.

**Comment 7** Our review was based on documentation provided. The projects in questions were originally charged to the CDBG program and presented to HUD as planning projects, and were therefore reviewed as such. While the City contends the Central Imperial project number one is eligible as an acquisition project, it was originally qualified and presented to HUD as a planning activity. Acquisition is not an eligible planning activity according to 24 CFR 570.205(a)(4). The Central Imperial project was qualified as planning, bypassing the need to document a national objective.

The OIG finds that approving CDBG funds for a specific activity and using the funds for a completely different activity, is an unacceptable practice. The CDBG regulations have a process in place that must be adhered to in order to ensure funds are used according to HUD rules and regulations.

**Comment 8** We disagree with the City’s contention that it merely “misclassified” projects as planning. We found, based on documentation and interviews with City and Agency staff, that the CDBG planning activity has often been used as a way to charge miscellaneous costs to CDBG. The practice in question was the result of a lack of controls, and a City environment where the use of the CDBG planning classification as a nonspecific spending account was considered acceptable. During the exit conference, the City’s Deputy Director of Economic Development agreed the attitude of previous CDBG staff was loose and lacked knowledge of CDBG rules and regulations.

**Comment 9** Although generally outside the scope of our audit, we cannot agree with the City’s assertion that early year expenditures of CDBG funds were for CDBG eligible activities that went through the City’s CDBG process. As described by our report and agreed to by the City, redevelopment projects were not submitted through the normal CDBG process and were not supported with required documentation. The City did not follow HUD rules or regulations when approving and processing redevelopment projects.

We also disagree with the City’s claim that CDBG funds were not used as a leveraging tool to obtain state tax increments. While the intent of the City may not have been leveraging alone, the City’s actions rendered CDBG funds recorded as loans as a leveraging tool to improve their ability to obtain tax increment funds.

**Comment 10** We agree with the City that the CDBG program can be used in conjunction with redevelopment funds when all applicable rules and regulations are followed. However, as reflected in finding one, the eligibility of activities funded with CDBG loans is still in question.

**Comment 11** We agree with the City that each project area must be given individual consideration when determining the repayment of CDBG loans.

However, we disagree with the City’s portrayal of the redevelopment repayment process. California Redevelopment Law imposes a time limit when a redevelopment agency can repay debt, not a time period, i.e. 10 years, when they should repay debt. An agency can repay debt at any point for a project area, up to ten years after the effective date of the project area. For project areas adopted prior to December 31, 1993, an agency has up to 50 years (40 years plus 10 year extension) to repay debt, depending on the redevelopment plan (Health and Safety Code 33333.6). For project areas adopted after January 1, 1994, an agency has up to 45 years, depending on the redevelopment plan, to repay debt (Health and Safety Code 33333.2). The dates may be earlier based on the project area timeframes provided in each redevelopment plan.

**Comment 12** The City characterized our recommendation as “forcing repayment.” Our recommendation is for the City to create loan agreements with specific terms, and on page 8 of the City’s response, it agrees to create loan agreements between the City and the Agency indicating specific loan terms. We agree that the loan terms may vary based on the specific redevelopment project area and tax increment revenue. No evidence has been provided to show a repayment schedule will harm the revitalization effort, and if done properly and according to CDBG rules and regulations, it will ensure a constant flow of funds to continue to develop low- and moderate-income communities and to eliminate blight through the reuse of program income.

**Comment 13** No documentation or analysis has been submitted to show that only 1.04 percent of the tax increment received was attributable to CDBG debt.

**Comment 14** Leveraging is not listed as a CDBG-eligible activity under 24 CFR 570. The City’s action of disregarding HUD rules and regulations, and general lack of repayment on outstanding CDBG loans, resulted in our description of the City’s CDBG loan process as a leveraging tool.

## Appendix C

Schedule of Ineligible and Unsupported Costs by Project/Activity

NO.	Project	Principal balance June 30, 2007	Interest balance June 30, 2007	Unsupported	Ineligible	TOTAL
1	Central Imperial Project	\$ 144,993.00	\$ 205,748.73	\$ -	\$ 144,993.00	\$ 144,993.00
2	Barrio Logan Project	\$ 133,018.44	\$ 67,090.22	\$ 133,018.44	\$ -	\$ 133,018.44
3	Centre City East District	\$ 1,250,000.00	\$ 460,011.92	\$ 1,250,000.00	\$ -	\$ 1,250,000.00
4	C.I. - North Creek Site	\$ 145,000.00	\$ 75,037.50	\$ 145,000.00	\$ -	\$ 145,000.00
5	C.I. - North Creek Site	\$ 275,207.00	\$ 154,734.15	\$ 275,207.00	\$ -	\$ 275,207.00
6	City Heights Project	\$ 20,000.00	\$ 9,927.25	\$ 20,000.00	\$ -	\$ 20,000.00
7	Central Imperial Project	\$ 1,291,010.99	\$ 650,965.60	\$ -	\$ 1,291,010.99	\$ 1,291,010.99
8	Barrio Logan Project	\$ 7,626.46	\$ 2,292.76	\$ 7,626.46	\$ -	\$ 7,626.46
9	Central Imperial Project	\$ 16,000.00	\$ 8,280.00	\$ 13,980.00	\$ 2,020.00	\$ 16,000.00
10	Central Imperial Project	\$ 93,624.99	\$ 38,979.33	\$ 93,624.99	\$ -	\$ 93,624.99
11	Central Imperial Project	\$ 717,264.00	\$ 363,755.31	\$ 717,264.00	\$ -	\$ 717,264.00
12	C.I. - North Creek Site	\$ 500,000.00	\$ 205,000.00	\$ 500,000.00	\$ -	\$ 500,000.00
13	C.I. - Commercial Rehabilitation	\$ 36,601.38	\$ 18,204.33	\$ 31,537.38	\$ 5,064.00	\$ 36,601.38
14	Southcrest Residential Development -Alpha St	\$ 45,000.00	\$ -	\$ 45,000.00	\$ -	\$ 45,000.00
15	Southcrest Project	\$ 732,123.00	\$ -	\$ 706,131.90	\$ 25,991.10	\$ 732,123.00
16	Barrio Logan Project	\$ 14,380.16	\$ 5,895.86	\$ 14,380.16	\$ -	\$ 14,380.16
17	Southcrest Residential Development -Alpha St	\$ 266,952.81	\$ -	\$ 266,952.81	\$ -	\$ 266,952.81
18	C.I. - North Creek Site	\$ 352,000.00	\$ 144,221.73	\$ 352,000.00	\$ -	\$ 352,000.00
19	Southcrest Commercial Revitalization / Linear Park	\$ 109,200.00	\$ 36,904.54	\$ 109,200.00	\$ -	\$ 109,200.00
20	Crossroads Project	\$ 100,000.00	\$ 33,195.92	\$ 100,000.00	\$ -	\$ 100,000.00
21	North Park Public Parking Lot	\$ 900,000.00	\$ 186,251.72	\$ 900,000.00	\$ -	\$ 900,000.00
22	Central Imperial Project	\$ 545,043.01	\$ 165,513.44	\$ 478,041.27	\$ 67,001.74	\$ 545,043.01
23	Southcrest Residential Development -Alpha St	\$ 181,980.40	\$ -	\$ 181,980.40	\$ -	\$ 181,980.40
24	C.I. - Industrial Site Acquisition	\$ 1,107,374.00	\$ 355,614.69	\$ 1,107,374.00	\$ -	\$ 1,107,374.00
25	C.I. - North Creek Site	\$ 502,042.34	\$ 161,281.11	\$ 502,042.34	\$ -	\$ 502,042.34
26	Southcrest Commercial Revitalization / Linear Park	\$ 500,000.00	\$ 160,625.00	\$ 500,000.00	\$ -	\$ 500,000.00
27	Crossroads Project	\$ 100,000.00	\$ 32,125.00	\$ 66,089.39	\$ 33,910.61	\$ 100,000.00
28	C.I. - North Creek Site	\$ 340,039.66	\$ 77,344.78	\$ 340,039.66	\$ -	\$ 340,039.66
29	Crossroads Project	\$ 378,293.82	\$ 90,222.75	\$ 377,093.82	\$ 1,200.00	\$ 378,293.82
30	Grantville Project	\$ 125,000.00	\$ 24,436.45	\$ 125,000.00	\$ -	\$ 125,000.00
31	Central Imperial project	\$ 1,108,458.73	\$ 195,083.07	\$ 1,108,458.73	\$ -	\$ 1,108,458.73
32	Grantville Project	\$ 350,000.00	\$ 63,928.49	\$ 350,000.00	\$ -	\$ 350,000.00
33	Grantville Project	\$ 31,728.51	\$ 1,467.44	\$ 31,728.51	\$ -	\$ 31,728.51
34	Central Imperial	\$ 570,000.00	\$ 67,704.89	\$ 334,421.55	\$ 235,578.45	\$ 570,000.00
35	Grantville Project	\$ -	\$ -	\$ -	\$ -	\$ -
<b>TOTALS</b>		<b>\$ 12,989,962.70</b>	<b>\$ 4,061,843.98</b>	<b>\$ 11,183,192.81</b>	<b>\$ 1,806,769.89</b>	<b>\$ 12,989,962.70</b>

# Appendix D

## Schedule of administrative deficiencies by project/activity

NO.	Project	Amount	101	102	103	104	105	106	107	108
1	Central Imperial Project	\$ 144,993.00	No							
2	Barrio Logan Project	\$ 133,018.44	No	Yes						
3	Marina Residential/Centre City East District	\$ 1,250,000.00	No	Yes						
4	Central Imperial - North Creek Site	\$ 145,000.00	No							
5	Central Imperial - North Creek Site	\$ 275,207.00	No							
6	City Heights Project	\$ 20,000.00	No	Yes						
7	Central Imperial Project	\$ 1,291,010.99	No							
8	Barrio Logan Project	\$ 7,626.46	No	Yes						
9	Central Imperial Project	\$ 16,000.00	No							
10	Central Imperial - Industrial Site Acquisition	\$ 93,624.99	No							
11	Central Imperial - North Creek Site	\$ 717,264.00	No							
12	Central Imperial - North Creek Site	\$ 500,000.00	No							
13	CI - Commercial Rehabilitation	\$ 36,601.38	No	Yes						
14	Southcrest Residential Development -Alpha St	\$ 45,000.00	No	Yes						
15	Southcrest Project	\$ 732,123.00	No	Yes						
16	Barrio Logan Project	\$ 14,380.16	No							
17	Southcrest Residential Development -Alpha St	\$ 266,952.81	No	Yes						
18	Central Imperial - North Creek Site	\$ 352,000.00	No							
19	Commercial Revitalization / Linear Park	\$ 109,200.00	No	Yes						
20	Crossroads Project	\$ 100,000.00	No	Yes						
21	North Park Public Parking Lot	\$ 900,000.00	No	Yes						
22	Central Imperial Project	\$ 545,043.01	No	Yes						
23	Southcrest Residential Development -Alpha St	\$ 181,980.40	No	Yes						
24	Central Imperial - Industrial Site Acquisition	\$ 1,107,374.00	No							
25	Central Imperial - North Creek Site	\$ 502,042.34	No							
26	Commercial Revitalization / Linear Park	\$ 500,000.00	No	Yes						
27	Crossroads Project	\$ 100,000.00	No	Yes						
28	Central Imperial - North Creek Site	\$ 340,039.66	No							
29	Crossroads Project	\$ 378,293.82	No	Yes						
30	Grantville Project	\$ 125,000.00	No	Yes						
31	Central Imperial Project	\$ 1,108,458.73	No							
32	Grantville Project	\$ 350,000.00	No	Yes						
33	Grantville Project	\$ 31,728.51	No							
34	Central Imperial Marketplace	\$ 570,000.00	No							
35	*Grantville Project	\$ -	No	No	Yes	N/A	No	No	No	Yes
	<b>TOTAL</b>	<b>\$ 12,989,962.70</b>								

\*No expenditures were charged to this project, so the current loan balance is zero.

Table legend	
#	Description
101	CDBG loan/project agreements
102	Initial overall CDBG project eligibility determined
103	Listed in consolidated action plan
104	Listed in action plan amendment
105	Project activities monitored
106	Specific project costs CDBG eligibility reviewed
107	CDBG exclusive files maintained
108	IDIS drawdowns equal expenditures amounts

## Appendix E

### Schedule of outstanding CDBG redevelopment loans

Project	Principal balance June 30, 2007	Interest balance June 30, 2007	Total due June 30, 2007
Barrio Logan	\$ 1,958,115.33	\$ 2,433,871.43	\$ 4,391,986.76
Central Imperial	\$ 13,628,095.15	\$ 7,699,478.49	\$ 21,327,573.64
Centre City	\$ 28,441,579.82	\$ 44,299,500.47	\$ 72,741,080.29
City Heights	\$ 2,138,481.40	\$ 2,018,337.47	\$ 4,156,818.87
College Community	\$ 365,000.00	\$ 359,745.93	\$ 724,745.93
College Grove	\$ -	\$ -	\$ -
Crossroads	\$ 578,293.82	\$ 155,543.67	\$ 733,837.49
Gateway Center West	\$ 5,599,738.19	\$ 12,072,677.35	\$ 17,672,415.54
Grantville	\$ 506,728.51	\$ 89,832.38	\$ 596,560.89
Horton Plaza	\$ -	\$ -	\$ -
Linda Vista	\$ 810,690.82	\$ 2,051,528.29	\$ 2,862,219.11
Market Street	\$ -	\$ -	\$ -
Mount Hope	\$ 429,176.72	\$ 70,814.16	\$ 499,990.88
Naval Training Center	\$ 149,000.00	\$ 138,197.50	\$ 287,197.50
North Bay	\$ -	\$ -	\$ -
North Park	\$ 1,539,272.00	\$ 992,731.67	\$ 2,532,003.67
San Ysidro	\$ 737,000.00	\$ 816,124.92	\$ 1,553,124.92
Southcrest	\$ 5,861,390.03	\$ 2,633,364.66	\$ 8,494,754.69
Dells Imperial - survey area	\$ 305,397.99	\$ 285,152.53	\$ 590,550.52
Pacific Beach - survey area	\$ 25,000.00	\$ 12,136.27	\$ 37,136.27
<b>TOTALS</b>	<b>\$ 63,072,959.78</b>	<b>\$ 76,129,037.19</b>	<b>\$ 139,201,996.97</b>

# Appendix F

## Outstanding CDBG Debt – Central Imperial

Fiscal year	Dept	Org	Principal balance June 20, 2007	Average principal	Interest (prime+2%) 9.25%	Interest balance June 30, 2007	Total due
1988	5635	3501	\$ 1,961.16	\$ 1,961.16	\$ 181.41	\$ 911.94	\$ 2,873.10
1990	5885	8503	60,316.72	60,316.72	5,579.30	28,047.28	88,364.00
1994	4042	4233	80,223.00	80,223.00	7,420.63	37,303.70	117,526.70
1995	4062	6240	166,000.00	166,000.00	15,355.00	77,190.00	243,190.00
1996	4082	8236	451,000.00	451,000.00	41,717.50	391,638.01	842,638.01
1997	4114	1413	216,928.06	216,928.06	20,065.85	179,915.98	396,844.04
1998	4130	3003	284,000.00	284,000.00	26,270.00	217,670.68	501,670.68
1999	4162	6236	120,767.00	120,767.00	11,170.95	92,024.79	212,791.79
1999	4160	6007	481,800.00	481,800.00	44,566.50	250,507.98	732,307.98
1999	4160	6007	211,300.00	211,300.00	19,545.25	160,208.77	371,508.77
2000	4180	8005	144,993.00	144,993.00	13,411.85	205,748.73	350,741.73
2000	4194	9406	1,079,710.99	1,079,710.99	99,873.27	557,798.64	1,637,509.63
2001	4211	1104	16,000.00	16,000.00	1,480.00	8,280.00	24,280.00
2003	4250	5004	545,043.01	545,043.01	50,416.48	165,513.44	710,556.45
2005	4292	9237	654,003.00	654,003.00	60,495.28	113,039.94	767,042.94
2006	4331	3119	380,000.00	374,272.60	34,620.22	47,979.98	427,979.98
1996	4087	8703	13,640.00	13,640.00	1,261.70	10,594.91	24,234.91
1999	4162	6236	100,000.00	100,000.00	9,250.00	70,110.94	170,110.94
2001	4213	1353	36,601.38	36,601.38	3,385.63	18,204.33	54,805.71
1985	5813	1321	39,341.00	39,341.00	3,639.04	51,340.02	90,681.02
1986	5833	3305	135,659.00	135,659.00	12,548.46	166,772.42	302,431.42
1993	4022	2206	66,703.94	66,703.94	6,170.11	75,041.92	141,745.86
1995	4062	6240	53,000.00	53,000.00	4,902.50	55,444.81	108,444.81
1995	4062	6240	105,000.00	105,000.00	9,712.50	99,317.50	204,317.50
1995	4064	6404	96,340.17	96,340.17	8,911.47	73,754.82	170,094.99
1995	4062	6240	147,000.00	147,000.00	13,597.50	154,193.35	301,193.35
1996	4082	8236	120,000.00	120,000.00	11,100.00	107,443.37	227,443.37
1997	4114	1413	6,000.00	6,000.00	555.00	4,942.50	10,942.50
1998	4132	3239	33,999.47	33,999.47	3,144.95	10,744.33	44,743.80
1999	4162	6236	26,913.53	26,913.53	2,489.50	20,267.23	47,180.76
1995	4062	6240	12,000.00	12,000.00	1,110.00	13,159.74	25,159.74
1995	4062	6245	175,000.00	175,000.00	16,187.50	180,687.50	355,687.50
1996	4082	8236	125,000.00	125,000.00	11,562.50	110,690.37	235,690.37
1997	4114	1413	21,000.00	21,000.00	1,942.50	17,298.75	38,298.75
1997	4125	2505	349,000.00	349,000.00	32,282.50	251,964.43	600,964.43
2000	4194	9406	65,200.00	65,200.00	6,031.00	33,741.00	98,941.00
2001	4213	1357	93,624.99	93,624.99	8,660.31	38,979.33	132,604.32
2003	4252	5234	1,107,374.00	1,107,374.00	102,432.10	355,614.69	1,462,988.69
2005	4292	9237	300,000.00	300,000.00	27,750.00	58,463.60	358,463.60
2006	4331	3119	190,000.00	161,287.35	14,919.08	19,724.91	209,724.91
1996	4082	8239	1,295,000.00	1,295,000.00	119,787.50	1,226,713.12	2,521,713.12
1997	4114	1413	33,000.00	33,000.00	3,052.50	27,183.75	60,183.75
1998	4132	3240	339,917.00	339,917.00	31,442.32	267,737.83	607,654.83
1999	4162	6236	515,626.00	515,626.00	47,695.41	371,187.09	886,813.09
2000	4182	8242	275,207.00	275,207.00	25,456.65	164,734.15	439,941.15
2000	4181	8128	145,000.00	145,000.00	13,412.50	75,037.50	220,037.50
2000	4194	9406	146,100.00	146,100.00	13,514.25	59,425.96	205,525.96
2001	4213	1350	717,264.00	717,264.00	66,346.92	363,755.31	1,081,019.31
2001	4213	1360	500,000.00	500,000.00	46,250.00	205,000.00	705,000.00
2002	4233	3341	352,000.00	352,000.00	32,560.00	144,221.73	496,221.73
2003	4252	5233	502,042.34	502,042.34	46,438.92	161,281.11	663,323.45
2004	4272	7235	340,039.66	340,039.66	31,453.67	77,344.78	417,384.44
2005	4292	9237	154,455.73	139,117.61	12,868.38	23,579.53	178,035.26
<b>Totals</b>			<b>\$ 13,628,095.15</b>	<b>\$ 13,578,316.98</b>	<b>\$ 1,255,994.36</b>	<b>\$ 7,699,478.49</b>	<b>\$ 21,327,573.64</b>

Table Note: The City did not receive a single payment on principal or interest for the CDBG loans represented in the project area above.

## Appendix G

### Schedules for CDBG Loan Repayment Estimates

#### Interest Rate Applied by City to CDBG Loans

Fiscal year	Interest rate
2000	9.75%
2001	10.50%
2002	11.00%
2003	6.75%
2004	6.25%
2005	6.00%
2006	7.25%
2007	9.25%
<b>Average interest rate</b>	<b>8.34%</b>

#### Estimated Annual Repayment Necessary to Repay Loans Within 30 Years

Outstanding loans		Interest rate	Loan term	Monthly payment	Expected annual payment
<b>Principal</b>	\$ 63,072,959.78	8.34%	30	\$ (478,009.44)	\$ (5,736,113.32)
<b>Interest</b>	\$ 76,129,037.19	0.00%	30	(211,469.55)	(2,537,634.57)
<b>Totals</b>				<b>\$ (689,478.99)</b>	<b>\$ (8,273,747.90)</b>

Account name	Revenue June 30, 2000	Revenue June 30, 2001	Revenue June 30, 2002	Revenue June 30, 2003	Revenue June 30, 2004	Revenue June 30, 2005	Revenue June 30, 2006	Revenue June 30, 2007	Totals
City loans schedules	\$ -	\$ 762,190.58	\$ 1,108,275.81	\$ 2,439,416.34	\$ 1,389,366.62	\$ 1,131,903.00	\$ 720,000.00	\$ 480,000.00	\$ 8,031,152.35
Actual average annual payment received (\$8,031,152 / 8 years)									\$1,003,894.04
Funds to be put to better use (\$8,273,748 - \$1,003,894)									\$ 7,269,853.85

#### Average CDBG Loan Repayments and Estimated Funds to be Put to Better Use

## Appendix H

### CRITERIA

#### Federal (HUD) Regulations at 24 CFR

**85.40(a)** states that grantees are responsible for managing the day-to-day operations of grant- and subgrant-supported activities. Grantees must monitor grant- and subgrant-supported activities to ensure compliance with applicable federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function, or activity.

**91.505(a)** states that the jurisdiction shall amend its approved consolidated plan whenever it makes one of the following decisions: (1) to make a change in its allocation priorities or a change in the method of distribution of funds; (2) to carry out an activity, using funds from any program covered by the consolidated plan (including program income), not previously described in the action plan; or (3) to change the purpose, scope, location, or beneficiaries of an activity.

**570.200(a)** states that an activity may be assisted in whole or in part with CDBG funds only if it meets certain requirements. The first requirement specifies that each activity must meet the eligibility requirements of Section 105 of the Act. Another requirement stipulates that the grant recipient must certify that its projected use of funds has been developed so as to give maximum feasible priority to activities which will carry out one of the national objectives of benefit to low- and moderate-income families, aid in the prevention or elimination of slums or blight, or meet other community development needs having a particular urgency because existing conditions pose a serious and immediate threat to the health or welfare of the community when other financial resources are not available to meet such needs. Consistent with the foregoing, each recipient must ensure and maintain evidence that each of its activities assisted with CDBG funds meets one of the three national objectives as contained in its certification.

**570.200(f)** states that CDBG activities may be undertaken by one or more public agencies through loans, subject to local law.

**570.200(h)** states that before the effective date of the grant agreement, a recipient may incur costs or may authorize a sub-recipient to incur costs, then after the effective date of the grant agreement, pay for those costs using its CDBG funds, provided that the activity for which the costs are being incurred is included in a consolidated plan, action plan, or an amended consolidated plan or action plan (or application under subpart M of this part) before to the costs are incurred.

**570.205(a)(4)iii** states that planning activities consist of all costs of data gathering, studies, analysis, and preparation of plans and the identification of actions that will implement such plans, including but not limited to other plans and studies such as individual project plans (excluding engineering and design costs related to a specific activity which are eligible as part of the cost of such activity under sections 570.201-570.204).

**570.205(a)(6)** states that among eligible planning activities are policy, planning, management, and capacity building activities which will enable the recipient to (1) determine its needs; (2) set long-term goals and short-term objectives, including those related to urban environmental design; (3) devise programs and activities to meet these goals and objectives; (4) evaluate the progress of such programs and activities in accomplishing these goals and objectives; and (5) carry out management, coordination, and monitoring of activities necessary for effective planning implementation but excluding the costs necessary to implement such plans.

**570.207(a)(2)** states that expenses required to carry out the regular responsibilities of the unit of general local government are not eligible for assistance except as otherwise specifically authorized.

**570. 208(a)(1)(i)** states that an activity with a national objective benefitting low- and moderate-income persons in an area (LMA) that serves an area that is not primarily residential in character shall not qualify under this criterion.

**570. 208(d)(4)** states that CDBG funds expended for planning and administrative costs under Sec. 570.205 and Sec. 570.206 will be considered to address the national objectives.

**570.501(a)** states that one or more public agencies, including existing local public agencies, may be designated by the chief executive officer of the recipient to undertake activities assisted by this part. A public agency so designated shall be subject to the same requirements as are applicable to sub-recipients.

**570.501(b)** states that the recipient is responsible for ensuring that CDBG funds are used in accordance with all program requirements. The use of designated public agencies, sub-recipients, or contractors does not relieve the recipient of this responsibility. The recipient is also responsible for determining the adequacy of performance under sub-recipient agreements and procurement contracts and for taking appropriate actions when performance problems arise. When a unit of general local government is participating with or as part of an urban county or as part of a metropolitan city, the recipient is responsible for applying to the unit of general local government the same requirements as are applicable to sub-recipients.

**570.503(a)** states that before disbursing any CDBG funds to a sub-recipient, the recipient shall sign a written agreement with the sub-recipient. The agreement shall remain in effect during any period during which the sub-recipient has control over CDBG funds, including program income.

**570.503(b)** states that at a minimum, the written agreement with the sub-recipient shall include the following provisions: (1) statement of work, (2) records and reports, (3) program income, (4) uniform administrative requirements, (5) other program requirements, (6) suspension and termination, and (7) reversion of assets. For the statement of work, the agreement shall include a description of the work to be performed, a schedule for completing the work, and a budget.

**570.504(a)** requires the grantee to record receipt and expenditure of program income as part of the financial transactions of the grant program.

**570.506(a), (b), and (h)** require each recipient to establish and maintain sufficient records to enable the HUD Secretary to determine whether the recipient has met the requirements of this part.

- (a) The recipient shall maintain records which provide a full description of each activity assisted with CDBG funds, including its location and the amount of CDBG funds budgeted, obligated, and expended for the activity.
- (b) The recipient shall maintain records which demonstrate that each activity undertaken meets one of the criteria used to determine whether a CDBG-assisted activity complies with one of more of the national objectives.
- (h) Recipients shall maintain evidence to support how the CDBG funds provided to such entities are expended. Such documentation must include, to the extent applicable, invoices, schedules containing comparisons of budgeted amounts and actual expenditures, construction progress schedules signed by appropriate parties, and/or other documentation appropriate to the nature of the activity.

**OMB Circular A-87, attachment A**, states that to be allowable under federal awards, costs must be necessary and reasonable for proper and efficient performance and administration of federal awards. A cost is reasonable if, in its nature and amount, it does not exceed what a prudent person would incur under the circumstances prevailing at the time the decision was made. In determining reasonableness of a given cost, consideration shall be given to (a) whether the cost is of a type generally recognized as ordinary and necessary for the operation of the governmental unit or the performance of the federal award; (b) the restraints or requirements imposed by such factors as sound business practices; arms length bargaining; federal, state, and other laws and regulations; and terms and conditions of the federal award; (c) market prices for comparable goods or services; (d) whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the governmental unit, its employees, the public at large, and the federal government; and (e) significant deviations from the established practices of the governmental unit which may unjustifiably increase the federal award's cost.

**OMB Circular A-87(14), attachment A** states that costs of entertainment, including amusement, diversion, and social activities and any costs directly associated with such costs (such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities) are unallowable.

**OMB Circular A-87(19), attachment B** states that the general costs of government are unallowable (except as provided in section 43 of this appendix, travel costs). These costs include (1) salaries and expenses of the office of the governor of a state or the chief executive of a political subdivision or the chief executive of federally recognized Indian tribal government; (2) salaries and other expenses of a state legislature county supervisor, city council, school board, etc., whether incurred for purposes of legislation or executive direction; (3) costs of the judiciary branch of a government; (4) costs of prosecutorial activities unless treated as a direct cost to a specific program if authorized by program statute or regulation (however, this does not preclude the allowability of other legal activities of the attorney general); and (5) costs of other general

types of government services normally provided to the general public, such as fire and police, unless provided for as a direct cost under a program statute or regulation.

### City Policies and Procedures

The city council's policy on CDBG funds states that it is the policy of the city council to allocate CDBG funds in accordance with the following standards: (1) selection and implementation of program activities must meet the congressional intent of the program and the specific eligibility requirements as outlined by HUD and (2) priorities of the Capital Improvements Program will be developed irrespective of whether the City is to receive CDBG funds. CDBG funds, if received, are to be used to supplement the City's Capital Improvements Program and not as a substitute for other City funds.

The City's consolidated annual performance and evaluation report for fiscal year 2006 (pages 33 and 34) stated that the City's nonhousing programs supported with federal entitlement funds and subject to the consolidated plan would be monitored to ensure compliance with the respective program requirements of the specific funding source. The City's approach to monitoring is an ongoing process involving continuous communication with and evaluation of grant recipients (nonprofit organizations, other governmental agencies, City departments).

The City performs the following monitoring functions:

- Make available to grant recipients (i.e., nonprofit organizations) general information on specific federal funds program requirements (i.e., OMB circulars, program regulations),
- Review all grant recipients' reimbursement requests through desk audits to ensure that specific program requirements are met,
- Review and determine eligibility of all applications according to specific federal funds criteria, and
- Provide technical assistance to grant recipients in various program areas.

The monitoring process involves frequent telephone contacts, written communications, analysis of reports and audits, desk audits, on-site monitoring, and meetings. The City's goal is to ensure compliance with specific program requirements for the applicable funding source. The primary goal of monitoring is to identify deficiencies and promote corrections to improve, reinforce, or augment grant recipients' performance.