



THE CITY OF SAN DIEGO  
**REPORT TO THE CITY COUNCIL**

DATE ISSUED: January 7, 2008 REPORT NO: 07-208

ATTENTION: Members of the Budget Committee  
Meeting of January 9, 2008

SUBJECT: Community Development Block Grant Program

REFERENCE:

REQUESTED ACTIONS:

Accept report and approve staff recommendations. Direct staff to incorporate accepted recommendations into Council Policy 700-02 (Community Development Block Grant Program) and forward to City Council for approval.

STAFF RECOMMENDATIONS:

1. Minimum allocation of \$25,000 per project, as approved by Budget Committee on December 6, 2007
2. Funds must be used within 3 years or automatically reprogrammed
3. No subrecipient agreements in the category of "Planning"
4. Staff will implement a "Community Based Development Organization (CBDO) Certification Process" for FY'09
5. Mandatory workshops for all CDBG Applicants
6. Applications deemed "questionable or ineligible" by staff shall not be forwarded to or funded by Council; no allocations to projects without applications
7. Eliminate paragraph #6 in Council Policy 700-02
8. Return to Budget Committee in 60-90 days to report on:
  - The City's Fair Housing Plan as required by HUD
  - The City's Management Plan as required by HUD
  - The City's Strategic Plan for CDBG in FY'10

SUMMARY:

At the December 6, 2007 Budget Committee hearing on the City's administration of the Federal Department of Housing and Urban Development's (HUD) Block Grant Program, staff was directed to return with additional policy recommendations aimed at improving the City's grant

management practices. The Budget Committee already approved setting a \$25,000 minimum grant amount for any FY'09 subrecipient agreements. The Budget Committee asked staff to suggest policy changes which could be implemented within the constrained timeline governing the FY'09 CDBG Program.

### Ad Hoc Group

For the past three (3) months, City Planning & Community Investment (CPCI) staff led weekly meetings and discussions with an ad hoc group. The ad hoc group was formed by Mayor Sanders in anticipation of receiving the latest HUD programmatic audit findings. Councilmember Toni Atkins had also suggested forming such a group during last spring's FY'08 Community Development Block Grant (CDBG) hearing.

The ad hoc group was tasked with reviewing the history of the City's management of the Block Grant program as well as reviewing recommendations for future program years. Attendees included representatives from the offices of Council Districts 1, 3, and 8; the Office of the Independent Budget Analyst (IBA); the City Auditor and Comptroller's Office; the San Diego Housing Commission; and the Mayor's Policy staff. The recommendations presented today have been vetted by this ad hoc group. The ad hoc group will continue to meet on the City's CDBG Strategic Plan for FY'10.

### Audits

Reforming the City's CDBG management policies has taken on an increasing sense of urgency, because of the number of recent HUD audit findings, the staff time required to remediate those concerns, and the potential consequences of not properly addressing the findings in a timely manner. Ultimately, the City could face financial sanctions and the potential suspension of the HUD Block Grant Program if our efforts prove unsuccessful or if additional findings are made by HUD. The City originally received notice of HUD's concerns in August 2007 regarding the City's compliance with HUD regulations. Subsequently, HUD officials have notified the City that additional compliance audits will be undertaken by HUD staff and representatives of the HUD Office of the Inspector General (OIG) Audit Division.

Personnel from the OIG have begun an onsite review of the City's compliance, which is scheduled to last approximately two (2) months. The result of this review will determine whether or not the OIG initiates a full four (4) month onsite audit. The focus of the OIG review is the City's practice of loaning and reloaning CDBG funds to the Redevelopment Agency. This particular use of CDBG funds was also the basis of one of HUD's September 2007 findings, which required the City to provide additional documentation of the financial accounting history of these loans dating back to FY'04.

Last month, HUD notified City staff that in February 2008, HUD will be conducting a review of the City's NEPA compliance procedures. HUD has also notified the City that it must create a plan regarding the City's implementation of Block Grant programs in accordance with Federal Fair Housing policies and that HUD officials will review the City's plan.

- All CDBG Audit findings will be reported to the City's Audit Committee

#### Fully compliant in FY'09/Strategic Initiative in FY'10

Mayor Sanders had initially ordered a comprehensive review of the City's CDBG Program in March, 2007 when the decision was made to transfer the administration of the Program to CPCI. The Mayor's direction was to ensure that the City was in full compliance with HUD regulations and to fully embrace the spirit and intent of the Federal Block Grant Program, which is primarily directed at the amelioration of conditions impacting low and moderate income individuals.

During the Budget Committee hearing in December 2007, Councilmembers also requested that in addition to the direction to bring immediate reforms to the January 2008 hearing, that CPCI staff and the ad hoc committee provide a more complete package of reforms for Council's consideration in the next few months. Councilmember Faulconer wanted to ensure that the additional time required would not cause the City to be out of compliance with the FY'09 CDBG Program. Staff responded that the immediate and necessary reforms to ensure complete compliance could be implemented for FY'09; however, the ultimate goal of strategically planning the City's investment of CDBG funds requires a fundamental change to the allocation process currently employed. Given the annual May (2008) HUD deadline for filing the City's action plan and the schedule for noticing the availability of funding for the non-profit organizations, there would be insufficient time to implement a more substantive change for FY2009. The City can fully comply with HUD regulations for FY2009, while anticipating an increased return on CDBG dollars invested in future years, by developing and implementing a strategic plan for CDBG which will be incorporated in the City's 5 Year Consolidated Plan beginning in FY2010

#### Recommendations to CDBG Program for FY'09

CPCI staff, through the ad hoc group, have addressed two (2) major areas of concern in addition to what the HUD audit findings have already revealed. They are: 1.) Problems specific to the City's subrecipient agreements with non-profit organizations that utilize CDBG funds for soft costs or non-capital expenditures (excluding social service programs and community-based development organizations); 2.) Problems with the City supplanting its municipal duties and those associated costs with HUD dollars.

#### Subrecipient Agreements with Non-profit Organizations

HUD allows CDBG recipients, which are generally municipal governments, to enter into subrecipient agreements with non-profit organizations for the delivery of services which meet one of HUD's national objectives. Over the past fourteen (14) years, the City has averaged one hundred eighty-one (181) subrecipient agreements annually, compared to the fifty (50) subrecipient agreements that the City averaged in the ten (10) years prior. Other cities with equivalent block grant budgets to the City of San Diego have fewer than one-third the number of subrecipient agreements.

In addition, the City of San Diego has had a problem with CDBG funds that have been budgeted for specific projects but remain unused. This impacts our ability to report accurately to HUD while meeting HUD's "timeliness" requirement and results in excessive use of staff time in tracking these funds. Therefore, it is recommended that funds are expended within 3 years or be reprogrammed.

Many of the recent HUD findings such as the lack of specificity in subrecipient agreements, the lack of proper monitoring of subrecipients, and the lack of ensuring subrecipient contract fulfillment are directly related to the number of annual agreements entered into by the City. The Budget Committee's initial recommendation to enforce a \$25,000 subrecipient agreement amount will greatly assist the City's ability to comply with HUD's findings, however, additional remedies are required so that the City can be fully HUD compliant.

The City Council has chosen to fund many worthy non-profit organizations which significantly contribute to the quality of life for San Diego's residents, however, many of these organizations are not eligible for HUD/CDBG dollars. A sampling of the most problematic concerns are as follows: 1.) Inappropriate use of funds for core funding or overhead costs, 2.) Planning activities used as a loophole to avoid meeting national objectives, 3.) Commercial revitalization activities substituting for economic development benefits for residents, and 4.) Organizations becoming too reliant on CDBG dollars.

Staff has recommended that the City no longer allocate funds to subrecipients in the "Planning" category. Many community based organizations which are not providing services to low-moderate income residents have applied under this category. Many of these same organizations have requested reimbursements for overhead expenses rather than planning services. The "planning and administrative" category is normally reserved for the Grantee to administer the program.

HUD allows certain soft costs or overhead to be used by Community Based Development Organizations (CBDO's). This requires the grantee (City of San Diego) to have a certification process for non-profit agencies to be designated as CBDO's. It is recommended that the City adopt a certification process for FY'09. Staff has already prepared the necessary forms for this process.

There are many exemplary subrecipient agreements with non-profit organizations with whom City of San Diego partners with that fully comply with and embody the spirit and intent of HUD's regulations. Some examples include: Replacing a roof or other tenant improvements in facilities owned by non-profit organizations who provide benefits to low and moderate income residents; purchasing a walk-in cooler for a food bank, which in turn distributes basic essentials to low and moderate income residents; and the demolition of a site for the development of affordable housing by a nonprofit.

- Details of changes to the FY'09 CDBG Program affecting applicants will be highlighted in the application cover letter

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  - Funds must be used within 3 years or automatically reprogrammed
  - No subrecipient agreements in the category of “Planning”
  - Staff will implement a “Community Based Development Organization (CBDO) Certification Process” for FY’09
  - Mandatory workshops for all CDBG Applicants
- To ensure that combined funding recommendations from the Council office for each application meets the proposed minimum project funding level, a summary of recommended allocations will be provided back to Council offices before Council approves the final allocations.

### Supplanting Issues

Under the former Council-Manager form of government, the City has historically supplanted costs associated with its municipal duties with the use of Federal Block Grant dollars. Remnants of those funding decisions can still be found within City departments. Typically, supplanting has occurred with either the installation of basic City infrastructure or the underwriting of staff costs. HUD guidelines, for instance, allow for the funding of code enforcement activities, if those staff resources are organized under a comprehensive plan which attempts to eliminate blighted conditions experienced by low and moderate income residents. The City has interpreted eligible code enforcement activities liberally to include funding of personnel as long as they worked in a Council District with eligible census tracts, or while proactively enforcing regulations rather than responding to complaints.

- CDBG Staff will work with the Neighborhood Code Compliance Program to develop a “comprehensive plan” to be in effect by July 1, 2008
- Approximately \$220,000 of the administrative costs for the Disability Services Program will be covered by the General Fund. This will meet HUD’s requirement that the same percentage of administrative costs be charged to CDBG as the % of time spent on CDBG funded projects.

Over the years, the City of San Diego has also funded basic infrastructure improvements with CDBG funds that should have been funded with other source of funds. If the City has a general obligation to provide certain infrastructure to its citizens, then using CDBG funds to provide that infrastructure in a low-moderate income community, while providing the same basic infrastructure in non-qualified census tracts, does not provide any “enhanced” benefit to the low-moderate income residents.

- Allocations will only be made for infrastructure improvements that are an “enhanced” benefit to the Low and Moderate income residents of the City of San Diego

### FISCAL CONSIDERATIONS:

No additional expense are anticipated in the FY2009 budget but certain budgeted revenues and expenses will be re-allocated with no net effect.

ATTACHMENTS:

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Scott Kessler  
Deputy Director  
Economic Development Division

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William Anderson  
Deputy Chief Operating Officer  
Land Use and Economic Development

Attachments:

1. Council Policy 700-02 on the CDBG Program.
2. FY'09 CDBG Process.