

Performance Deficiencies on CDBG Economic Development Activities

March 27, 1992

MEMORANDUM FOR: Richard L. Bauer, Regional Administrator - Regional Housing Commissioner, 10S

ATTENTION: John W. Peters, Regional Director, Community Planning and Development, 10C

FROM: Anna Kondratas, Assistant Secretary for Community Planning and Development, C

SUBJECT: Performance Deficiencies on Community Development Block Grant (CDBG) Economic Development Activities.

This is in response to John Peters' December 6, 1991, memorandum to Don I. Patch, Director, Office of Block Grant Assistance, requesting guidance in responding to the recommended corrective actions for Finding No. 2 of the OIG Region X audit report dated September 18, 1991, which cites program performance deficiencies in Community Development Block Grant (CDBG) funded economic development activities.

The Inspector General found a large number of businesses that received CDBG assistance had failed and that many assisted businesses had not produced the expected jobs long after the assistance had been provided. To correct this problem, they recommend that your office encourage grantees to establish standards to evaluate the effectiveness of their business loan programs, both in terms of the risk of financial failure of the business if the loan is made and the length of time allowed for a business to create jobs. If the actual experience of a grantee's business loan program were to fall outside of those standards, the grantee would be required to make changes in its program. The memorandum from John Peters questions whether it is appropriate for a Regional Office to encourage grantees to establish rates for failure and timeliness in achieving national objectives since this indirectly implies that whatever level of loan default or program progress they may establish would be acceptable to HUD. He also raises the issue of implications for national program policy and whether such actions should be taken by the Region without a regulatory change.

I am glad that you brought this matter to my attention. Although there may be some problems with establishing failure rates and timeliness measures for job creation, I do not believe that they would necessarily have implications to national CDBG policy. I believe that it is appropriate for a CDBG recipient to have an internal monitoring system for CDBG activities, including CDBG funded economic development activities, in order to ascertain whether or not the funded activities are achieving both CDBG program requirements and local community development objectives. In this particular case, establishing local default rates and timeliness standards are two measures that could be used by the recipient to monitor its program and determine whether or not its lending practices are in fact prudent. I agree that there is the potential for a recipient to set thresholds which are on their face unacceptably high, but in light of the fact that CDBG recipients cited in the audit are showing delinquent or defaulted loans of 30

percent, 40 percent, and 50 percent, some rates significantly below these figures would be acceptable as a monitoring mechanism for the recipient to reevaluate their lending and underwriting practices.

However, encouraging grantees to develop standards is not in itself the only action that HUD should be taking to address these findings. I believe that you should also respond by identifying the following additional actions which your office will take:

1. Advise its grantees that they should not fund economic development projects that do not appear to have a probable chance of financial success and of meeting a national objective within a reasonable period of time. The advice should indicate that a finding will be made in any case where a business is funded and a national objective is not met and that funding sanctions will be pursued if it is determined that the grantee did not act prudently.
2. Make efforts to determine whether an identified instance of non-compliance with the requirement to meet a national objective is an isolated incident or is part of a pattern of deficiencies. When a pattern of deficiencies is identified, the grantee would be advised to suspend funding of the activity in question until corrective actions are taken which can be expected to eliminate the problem in the future.
3. Pursue additional sanctions, including recovery of the CDBG funds expended on the project, following the guidelines in HUD Notice CPD 91-10, particularly in those instances where a grantee's program design did not determine that the business would likely succeed based on local program experience or where the grantee and the business had not identified the time period by which the business was to create the jobs and take other actions necessary to meet a national objective.
4. If the grantee fails to initiate outlined corrective actions within a timely manner or fails to act prudently in resolving such findings, the Field Office will refer the finding to Headquarters with a recommendation for appropriate sanctions based on the extent of the deficiencies and actions of the grantee to resolve them.

If you have any questions, please contact the Entitlement Communities Division at 8-458-1577.

cc: Linda Marston, SC