



U.S. Department of Housing and Urban Development
San Francisco Regional Office – Region IX
One Sansome Street, Suite 1200
San Francisco, California 94104-4430
www.hud.gov
espanol.hud.gov

MAR 12 2018

Ben Metcalf, Director
State of California
Department of Housing & Community Development
2020 West El Camino Ave, Suite 500
Sacramento, CA 95833

Dear Mr. Metcalf:

Subject: Onsite monitoring of State Community Development Block Grant, Community Development Block Grant Disaster Recovery, and Neighborhood Stabilization Program.

The purpose of this letter is to convey the results of the subject monitoring conducted by Community Planning and Development staff from the Headquarters, San Francisco and other field offices.

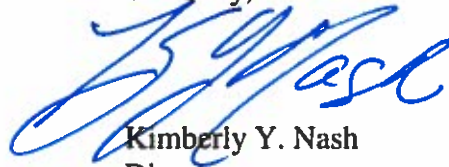
The Department of Housing and Urban Development is required to undertake program reviews, as necessary, to determine: (1) whether grantees have carried out their activities in accordance with the statutes, regulations, and are in compliance with the certifications, and; (2) whether they demonstrate a continuing capacity to carry out the programs in a timely manner.

The training, technical assistance, and monitoring was conducted on November 27 through December 1, 2017, and HUD's focus was on the administration and implementation of the State CDBG and NSP programs, as outlined in the enclosed monitoring report.

The monitoring resulted in the state of California being designated as a high-risk grantee. A total of twenty-five (25) findings and five (5) concerns were identified. Please note that our monitoring results are summarized by program area (CDBG, CDBG-DR, or NSP) as findings or concerns. Findings are violations of the statute or regulation that require resolution. Concerns do not include non-compliance; instead, they are meant to highlight issues that could lead to a finding if left unresolved.

HUD appreciates the assistance received from your staff during the review. If you have any questions about the report, feel free to contact me at 415-489-6572, or via email at Kimberly.y.nash@hud.gov. We look forward to working with you in the future.

Sincerely,



Kimberly Y. Nash
Director
Community Planning
and Development Division

Enclosure

cc:

Lisa Bates, Deputy Director, DFA

Maziar Movassaghi, Assistant Deputy Director, DFA

U.S. Department of Housing & Urban Development
San Francisco Field Office, California



Monitoring Report
Community Development Block Grant (CDBG)
Community Development Block Grant Disaster Recover (CDBG-DR)
Neighborhood Stabilization Program 1 (NSPI)

State of California
Department of Housing and Community Development

Monitoring Dates: *11/27 – 12/01, 2017*

OVERVIEW

Monitoring is the principal means by which HUD ensures that programs and technical areas are carried out efficiently, effectively, and that the programs comply with applicable laws and regulations. It assists grantees in improving their performance, developing or increasing capacity and augmenting their management and technical skills. Also, it provides a method for staying abreast of the efficacy of CPD-administered programs and technical areas within the communities HUD programs serve. Monitoring is not limited to a one-time review but is meant to be an ongoing process that assesses the quality of a grantee's performance over a period of time involving continuous communication and evaluation. In determining which grantees will be monitored, the Department uses a risk-based approach to rate grantees, programs and functions, including assessing the Department's exposure to fraud, waste and mismanagement. This process not only assists the Department in determining which grantees to monitor, but also identifies which programs and functions will be reviewed. Areas reviewed may result in the identification of findings, concerns or exemplary practices.

Specifics relating to this review are as follows:

Date(s) Monitoring Conducted: *11/27 – 12/01, 2017*

Type of Monitoring: *On-site*

HUD Reviewer(s): Jessie Handforth Kome, Director (Acting)
Kimberly Nash, CPD Director
James Höemann, Deputy Director
Winston Moy, Senior CPD Representative
Jean Richardson, CPD Representative
Robert Peterson, Senior CPD Specialist
Carey Whitehead, Attorney-Advisor
Terrance Ware, CPD Specialist
Cynthia Vails, Senior Financial Analyst
Marilee Hansen, NSP Specialist

HCD Representatives: Karen Patterson
Nicole McCay
Lisa Bates
Niki Dhillon
John Hiber
Kathryn Amann

Entrance Conference

Date: November 27, 2017

HUD Representatives: Jessie Handforth Kome, Director (Acting)
Kimberly Nash, CPD Director
James Höemann, Deputy Director
Winston Moy, Senior CPD Representative
Jean Richardson, CPD Representative
Robert Peterson, Senior CPD Specialist

HCD Representatives: Carey Whitehead, Attorney-Advisor
Terrance Ware, CPD Specialist
Cynthia Vails, Senior Financial Analyst
Marilee Hansen, NSP Specialist
Karen Patterson
Nicole McCay
Lisa Bates
Niki Dhillon
John Hiber
Kathryn Amann

Exit Conference

Date December 6, 2017
HUD Representatives: Jessie Handforth Kome, Director (Acting)
Kimberly Nash, CPD Director
James Höemann, Deputy Director
Winston Moy, Senior CPD Representative
Jean Richardson, CPD Representative
Robert Peterson, Senior CPD Specialist
Carey Whitehead, Attorney-Advisor
Terrance Ware, CPD Specialist
Cynthia Vails, Senior Financial Analyst
Marilee Hansen, NSP Specialist
HCD Representatives: Karen Patterson
Nicole McCay

SUMMARY OF RESULTS AND CONCLUSIONS

A Finding is identified as a deficiency in program performance based on a statutory, regulatory or program requirement for which sanctions or other corrective actions are authorized. A Concern is a deficiency in program performance that is not based on a statutory, regulatory or other program requirement but is brought to the grantee's attention.

The state must respond to all Findings within 30 days of this report and provide additional information that contests the basis of the Findings or demonstrates compliance with the program requirements. If the state fails to respond within 30 days or if the response is unsatisfactory to HUD, HUD advises the grantee to implement the corrective actions identified for all Findings. Recommended actions are identified for Concerns. Although you are not required to respond to a Concern, a response indicating any actions you are taking would be appreciated.

Programs: CDBG and CDBG-DR – This report details the results of the monitoring review and for the Community Development Block Grant (CDBG) and **Community Development Block Grant Disaster Recovery (CDBG-DR) programs**, containing **fifteen (15) findings and three (3) concerns**. On November 26, 2017, two members of the headquarters program office offered the training, *Basically CDBG for States* to 22 state staff, which was followed by IDIS (CDBG) and

DRGR (CDBG-DR and NDR) technical assistance, which a member of the San Francisco field office joined to deliver.

Based on HUD's review, HUD has determined that the state's administration of the program poses an unacceptably high risk of program noncompliance and nonperformance (2 CFR 200.205). HUD has observed that the state's administration of the CDBG program, current and historic, has failed to timely and effectively fulfill statutory obligations under title I of the Housing and Community Development Act of 1974 (Title I), and implementing regulations in 24 CFR Subpart I – State Community Development Block Grant Program, as outlined in this report. As a result of HUD's designation of the state as high risk, if the state cannot demonstrate that it met the program requirements discussed in each Finding, specific conditions pursuant to 2 CFR 200.207 are being imposed on the state's 2017 and any subsequent grants, and the state's open grants, until resolution of the actions contained within this report have been made to the satisfaction of HUD.

Program: NSP1 – This report details the results of the monitoring review and for the Neighborhood Stabilization Program 1 (NSP1). There are **ten (10) findings and two (2) concerns**. Technical assistance for the Disaster Recovery Grant Reporting (DRGR) system was provided. Further, more intensive technical assistance for the state's NSP1 and 3 grants will be provided in the very near future.

Your HUD representative, Winston Moy, Senior CPD Representative, is available to discuss the results of this monitoring report or provide technical assistance, if requested, and can be reached at (415) 489-6586, or at Winson.D.Moy@hud.gov. If you disagree with any of HUD's determinations or conclusions in this monitoring report, please address these issues in writing to this Department within 30 days of this report. Your written communication should explain your reasons why you disagree along with supporting evidence and documentation. All communication should be sent to:

Department of Housing and Urban Development
San Francisco Field Office, Community Planning and Development Division
One Sansome Street, Suite 1200
San Francisco, CA 94101-4430

The monitoring report has been divided by program area, with CDBG and CDBG-DR together beginning with the Scope of Review section below, followed by the details of NSP1 review.

SCOPE OF REVIEW – CDBG and CDBG-DR

On November 27 – December 1, 2017, the San Francisco field office and the headquarters program office conducted a monitoring of the state of California's CDBG and CDBG-DR programs.

The scope of the review included grantee capacity and risk evaluation, fiscal controls and accounting procedures, program income, timely distribution, state PER, overall benefit requirement, annual action plan, economic development and the public benefit standard, state's reviews and audits, and subgrantee closeouts.

In addition, interviews were conducted with personnel from the state Office of Housing and Community Development and select subgrantees of the state. The following exhibits were examined as part of the monitoring review:

- 4-3: Guide for Review of Overall Benefit Test
- 4-5: Guide for Review of Timely Distribution
- 4-6: Guide for State Review of Grant Recipients Performance
- 4-7: Guide for Review of Program Administration
- 4-8: Guide for Review of Closeout System

Area(S) Reviewed and Results

Area Tested: Grantee Capacity and High-Risk Assessment

High Risk Designation:

HUD initiated this monitoring visit based upon its review of current and long-term trend data available, and required but not available, in HUD's reporting and financial systems related to the state's funding under the CDBG (since 2010), NSP (since 2011), and CDBG-DR programs (since 2008). In assessing program risk prior to the visit, HUD also considered the presence of long-term, unresolved monitoring findings related to program administration. This information, as described elsewhere in this report, and communicated to state staff during the visit, indicated that the state was not using a significant amount of grant funds to achieve program objectives in a timely manner, and that the state's oversight of its grant recipients appeared to be deficient. Based on the information available, HUD questioned whether the state's performance might be so impaired as to warrant a grant reduction, adjustment, or conditions under Title I and applicable financial management regulations. In response to the identified risks and to further examine the state's performance through interviews and on-site file review, HUD scheduled an on-site monitoring visit at the state offices and at local grant recipient sites.

In addition to HUD field office staff assigned to routine day-to-day oversight for the state's grants, the monitoring team included program office subject matter experts, an attorney with subject matter expertise in the CDBG, CDBG-DR, and NSP programs, and a financial analyst experienced with troubled grantee programs. To identify specific management issues related to the identified risks, the team used the Overall Management review exhibit usually used in the Entitlement CDBG program in addition to the Exhibits customarily used for the State CDBG program. The determinations below are based on the monitoring team's interviews, documentation, and data reviews, which revealed numerous systemic issues.

During interviews, HUD reviewers were advised that the state had not provided sufficient resources to the staff administering the programs to allow for on-site reviews of local government projects during the two years prior to this visit. The state's Single Audit had not sampled the CDBG program in at least four years. The weakness of NOFA and subgrantee agreement requirements related to complete budgets (line of credit funds AND program income), performance schedules, and performance criteria; together with limited or unavailable

documentation on paid recipient invoices is described elsewhere in this report. Many procedures and policies available to grant recipients and state program oversight staff were described as out-of-date. Local grant recipients uniformly described state customer service as severely lacking in consistency and timeliness. Further, a majority of awarded activities and projects (back to those initiated in 2011) were never set up in IDIS, and the state has not submitted a Performance and Evaluation Report (PER) to HUD in the form required by the Department for several years.

The state has not distributed funds to units of general local government in a timely manner and has not conducted reviews and audits of units of general local government as are necessary to determine whether they have satisfied program performance criteria. (42 U.S.C. 5304(e) and (e)(2)). Further, the state did not evidence fiscal and administrative requirements for expending and accounting for all funds received that were sufficiently specific to ensure that grant funds are used in compliance with all applicable statutory and regulatory provisions. Further, the terms and conditions of awards to its recipients do not ensure that funds received are only spent for reasonable and necessary costs of operating programs (24 CFR 570.489(d)(1)(ii)).

All the elements noted above, and others noted elsewhere in this report, amount to a systemic failure that prevents the state from using program funds in accordance with program requirements, and creates significant risks of fraud, waste, and mismanagement of funds. While no specific instances of fraud were discovered, the monitoring team notes that increased fraud risks are associated with a lack of grantee oversight. When the state attempts to accelerate its use of funds, as it must to spend down the more than five-year backlog in grant funds and an undetermined amount of program income, if systemic issues are not first corrected, the systemic oversight flaws and significant risks are likely to result in further violations of HUD program requirements.

Based on its review and upon considering the state's history of performance, and its ability to effectively implement statutory, regulatory, and other CDBG program requirements, HUD has determined that the state's administration of its program poses an unacceptable high risk of program noncompliance and nonperformance (2 CFR 200.205). Accordingly, HUD is designating the state as a high-risk grantee for future awards.

The findings outlined in this report evidence a pattern of inadequate written policies, failure to comply with program-specific statutory and regulatory requirements, failure to adequately document compliance, inadequate systems and processes to ensure financial and program management standards are met, and more, as outlined further in this report. Therefore, HUD may impose additional grant conditions on the state's existing awards pursuant to 2 CFR 200.338, applicable when a grantee that has implemented the Uniform Administrative Requirements in 2 CFR part 200 (previously 24 CFR part 85) fails to comply with Federal statutes, regulations, or the terms and conditions of the grant award.

Within 30 days of the date of this report, the state must satisfactorily contest the basis of the Findings or demonstrate compliance with the program requirements. If the state fails to respond within 30 days or if the response is unsatisfactory to HUD, HUD recommends that the state suspend further disbursement of funds from its 2017 CDBG grant.

Additionally, pursuant to 24 CFR 570.485(d), 2 CFR 200.207, and 2 CFR 200.338, if the state cannot demonstrate to HUD's satisfaction that it met the program requirements discussed in each Finding, the following specific conditions on the state's open CDBG grants, the state's 2017 CDBG grant and future CDBG grants will be imposed:

Within 60 days of the date of this report, provide HUD a written management plan signed by the designated CDBG program official outlining the state's actions to resolve all HUD monitoring findings within fifteen months of this report, including names and contact information for assigned managers or staff responsible for each action, and including action start and end dates.

Within 60 days of the date of this report, sign a Memorandum of Understanding with HUD in which the state accepts additional technical assistance related to state administration of the program, including internal controls, process work flow, review of invoices, and program policies and procedures.

Within 60-days of the date of this report, create an oversight system for grant recipients that includes all required elements and resources, especially those related to budget, schedules, and performance requirements in NOFA and recipient agreements, documented invoices, and regular on-site and remote reviews of grant recipient performance and compliance.

Within 120-days of the date of this report, carry out a reasonable sample of recipient monitoring and document reviews.

Within 60-days of the date of this report, establish policies and procedures that will ensure that the state will set up all grant activities (or projects) in IDIS within 30 days of the announcement of awards for the 2017 and 2018 grant years.

Area Tested: Grantee Fiscal Controls and Accounting Procedures – Program Income

Finding 1: The state did not maintain up-to-date records to reflect current fiscal and administrative requirements and other policies and procedures.

Condition: The state's Grants Management Manual is out of date online. Some chapters indicate that they are being updated. During interviews, subgrantees complained that the state's online policies, procedures, and forms were consistently out of date.

For example, Chapter 13 of the Grants Management Manual provides that the "final [financial and accomplishment report] FAR must be submitted to the Department. The final Funds Request is due 45 days after grant expiration. The final Grantee Performance Report (GPR), Closeout Report, and any unused grant funds you have on hand are due within 90 days of contract expiration. The Final FAR can also be used as the Closeout Report (see II C)." However, the state indicated that both a FAR and GPR are no longer required. HUD could not determine which documents currently are required for closeout.

Criteria: 24 CFR 570.490(a)(1) requires the state to establish and maintain such records as may be necessary to facilitate review and audit by HUD of the state's administration of CDBG funds under 24 CFR 570.493.

Cause: The state's primary CDBG fiscal and administrative requirements are contained in the state regulations at title 25 of the California Code of Regulations. These regulations cannot be updated quickly enough to reflect current policies and procedures.

Effect: HUD could not reasonably understand which policies and procedures applied to state subgrantees during its monitoring because the state's online manual was outdated.

Corrective Action: The state should update its policies and procedures online. The state should seek appropriate revisions to Title 25 of the California Code of Regulations to incorporate the correct State CDBG requirements and applicable pieces of 2 CFR Part 200. The state should update online forms and develop a method for regularly advising its grantees of form updates. All forms should be clearly dated. The state should inform grantees whether they are subject to revised policies, or the policies in place at the time the grant agreement was signed, and if necessary, update grant agreements with units of general local government.

Finding 2: The state has not made changes to its agreements, policies, and procedures necessary to implement 2 CFR part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Requirements), to the extent required by HUD in the regulations at 24 CFR part 570, subpart I - State Community Development Block Grant Program.

Related Concern: The state may not have updated its agreements, policies, and procedures necessary to implement Uniform Administrative Requirements for other HUD grants that are subject to Federal regulations.

Condition: The state has not taken steps to implement new federal Uniform Administrative Requirements as required by HUD regulations and CPD Notices.

On December 26, 2013, the Office of Management and Budget (OMB) published (at 78 Federal Register 78608) the final Uniform Administrative Requirements, which are codified at 2 CFR part 200. The Uniform Administrative Requirements superseded, consolidated, and streamlined requirements from eight OMB Circulars. To implement these requirements, HUD adopted 2 CFR part 200 and incorporated its requirements by amending 24 CFR parts 84 and 85. As amended, 24 CFR 84.1(b) and 85.1(b) provide that "Where the terms of a Federal award made prior to December 26, 2014, state that the award will be subject to regulations as may be amended, the Federal award shall be subject to 2 CFR part 200." HUD's CDBG grant agreement with the state makes the state subject to regulations "as may be amended." Other CPD grant programs include similar language in their grant agreements, as discussed in CPD Notice 16-04.

The state's current CDBG policies, procedures, and open grant agreements have not been updated to implement the Uniform Administrative Requirements. For example, the state's CDBG Regulations, Grants Management Manual and its grant agreements with unexpected balances have not been updated to reflect the new audit requirements for federal awards. Section

7097 of title 25 of the California Code of Regulations, for example, still references superseded HUD regulations at 24 CFR part 85 and OMB circulars A-133 and A-87. Chapter 11 of the state's Grants Management Manual (OMB Circular A-133 SINGLE AUDIT REPORT), still references A-133 and the old requirements for non-federal entities that expend equal to or in excess of \$500,000 in federal awards within a fiscal year (July 1 - June 30) to have an audit performed in accordance with the Single Audit Act. Exhibit D to the state's standard agreement similarly references A-133 audit requirements.

OMB Circular A-133 was also superseded by the issuance of 2 CFR part 200, subpart F. Among other things, those changes increased the audit threshold to \$750,000 for auditee fiscal years beginning on or after December 26, 2014 and made changes to the major program determination process. The Office of Management and Budget also releases an annual 2 CFR PART 200, APPENDIX XI Compliance Supplement (Supplement) based on the requirements of 2 CFR part 200, subpart F, which assists auditors in performing the required audits.

Criteria: 24 CFR 570.489(d) requires the state to have fiscal and administrative requirements for expending and accounting for all funds received under this subpart. These requirements must be available for HUD's review and must be sufficiently specific to ensure that funds received under this subpart are used in compliance with all applicable statutory and regulatory provisions and the terms and conditions of the award. These applicable regulatory provisions include 24 CFR 570.489(n) (audit requirements in 2 CFR part 200, subpart F), 570.489(m) (making 2 CFR 200.330 – 200.332 applicable), 570.489(p) (cost principles in 2 CFR part 200, subpart E), and 570.489(g) (requiring subrecipient/contractor determinations in accordance with 2 CFR 200.330).

CPD Notice 16-04 provides additional guidance to State CDBG grantees regarding implementation of the Uniform Requirements, including the expectation that if a subgrantee is in the midst of implementing activities under an existing agreement which only cites part 84 or part 85 requirements, the agreement must be amended to apply the part 200 requirements to all obligations of funds on or after December 26, 2014.

Cause: The state's fiscal and administrative requirements have not been updated and contain references to superseded sections of HUD's regulations in 24 CFR parts 84 and 85, and old OMB Circulars. These outdated fiscal and administrative requirements are located in the State CDBG Regulations in Title 25, §§7050 – 7126 of the California Code of Regulations, the state's Grant Management Manual, and the state's standard agreements (grant agreements) with units of general local government.

Effect: The state's fiscal and administrative requirements are not sufficiently specific to ensure that CDBG funds received by the state and the units of general local government are used in compliance with all applicable regulatory provisions.

Corrective Action: The state could correct the finding by seeking amendment of its fiscal and administrative requirements located in the State CDBG Regulations in Title 25, §§7050 – 7126 of the California Code of Regulations, updating the state's Grant Management Manual, and updating the state's standard agreements (grant agreements) with units of general local government, and its policies and procedures that implement CDBG program requirements.

Similarly, the state should update agreements, policies, and procedures governing other CPD programs that are subject to part 200 requirements because the HUD grant agreement with the state is subject to regulations “as may be amended.”

Finding 3: There are insufficient internal controls in place to ensure that the CDBG funds are being used in compliance with all applicable statutory and regulatory provisions. For HUD administrative purposes, this finding incorporates Finding #1 from the March 2, 2017 HUD monitoring letter to the state of California Housing and Community Development (HCD) Department.

Condition: The Requests for Payment from the local governments are approved without reviewing actual costs which diminishes the effectiveness of the internal control of signed approvals. HCD does not verify the actual costs that are being paid with CDBG funds:

- The file for the County of Tuolumne 2014 file, contract #14-CDBG-9901 was missing the application for funds and did not contain any supporting documentation for the costs covered by CDBG.
- The 2015 file for the City of Arcata, contract #15-CDBG-10672 for the Wing Inflatables, Inc. economic development activity had a discrepancy between the \$2.7 million drawn in IDIS on Activity #24619 and the \$2.65 million in total costs for the activity as listed in a communication from the City of Arcata on January 13, 2016. There was no supporting documentation to show the actual costs that were incurred. For example, \$2,007,142.90 in CDBG was used to refinance a loan but there was no payoff letter in the file to verify the cost was incurred and nothing to verify that the payment was made to the bank. There was no support for the furnishings, materials, training, or buildout costs that were listed and nothing for the \$50,000 in planned activity delivery costs.

Criteria: Recordkeeping requirements at 24 CFR 570.490(a)(1) state that, “The State shall establish and maintain such records as may be necessary to facilitate review and audit by HUD of the state’s administration of CDBG funds under §570.493.” According to §570.493(b), “A State’s failure to maintain records in accordance with §570.490 may result in a finding that the State has failed to meet the applicable requirement to which the record pertains.” The state is required to have fiscal controls such that it can ensure the funds are used in “compliance with all applicable statutory and regulatory provisions,” “only spent for reasonable and necessary costs,” and “not used for general expenses required to carry out other responsibilities of state and local governments.” §570.489(d).

Cause: HCD does not require the local governments to submit back-up documentation when requesting payments and alternatively does not conduct sufficient on-site monitoring to verify the requisite records are maintained by all the local governments.

Effect: Without sufficient documentation to verify the drawn CDBG funds are being used in compliance with applicable statutory and regulatory provisions, cover costs that are necessary and reasonable, and are not used for general governmental operations, HCD’s internal controls do not meet the requirements of §570.489(d).

Corrective Action: HCD must establish sufficient internal controls to ensure records are maintained to evidence the CDBG funds are used in compliance with §570.489(d).

Finding 4: There are insufficient internal controls in place to evidence that program income (PI) is accurately reported in Integrated Disbursement Information System (IDIS) and used first by the local governments before drawing from the line of credit.

Condition: For the County of Tuolumne contract number 13-CDBG-9454, HCD's Consolidated Automated Program Enterprise System (CAPES) reported \$274,815 in CDBG disbursed and \$367,754 in CDBG program income (PI) disbursed for homeless services for IDIS Activity #24191. In IDIS, the total of drawdown vouchers for Activity #24191 added up to the \$274,815, which matched what was reported in CAPES for CDBG non-PI funds. However, IDIS draw voucher #5864645 for \$367,754 in CDBG program income was cancelled and therefore the two systems do not match on the amount of PI used. According to IDIS, the CDBG PI was not used on costs associated with IDIS Activity #24191 but the PI funds remain committed to the IDIS activity indicating that that the funds are being held for a future use.

Additionally, according to the IDIS PR01 report ran on November 28, 2017, there is a balance of \$3.1 million in program income (PI), for which the state did not have an explanation, citing their policy to only receipt program income as needed for draws.

Criteria: According to 24 CFR 570.489(e)(3)(i), "To the maximum extent feasible, the state must distribute program income before it makes additional withdrawals from the United States Treasury." Per 24 CFR 570.490(a)(3), "The state shall make entries into IDIS in a form prescribed by HUD to accurately capture the state's accomplishment and funding data, including program income."

Cause: While there are procedures to check for the use of program income, there are insufficient internal controls to ensure that CDBG program income funds are accurately accounted for and reported in IDIS.

Effect: For the County of Tuolumne contract number 13-CDBG-9454, HCD reported in IDIS that line of credit CDBG was drawn for use by a local government before using program income on hand.

Corrective Action: The state must establish policies and procedures for auditing the local governments' program income accounts and for periodically performing reconciliations with IDIS. The state must establish internal controls to ensure that decisions to perform draws and modify draws are based on accurate financial information and proper documentation. Furthermore, the state must establish internal controls to ensure the information reported to HUD on IDIS is accurate. Ultimately, the state must audit the local governments' program income accounts to determine the correct amount of PI that should be recorded in IDIS and make corrections in IDIS accordingly so that the local governments' accounts reconcile to IDIS rendering accurate reporting in IDIS.

Finding 5: There are insufficient internal controls in place to ensure that the local governments are maintaining CDBG program income revolving loan (RL) funds in separate accounts, that the funds are generated and used for specific, identified activities, and that the local governments are willing and able to continue those activities.

Condition: While the state of California Housing and Community Development (HCD) Department requires local governments to report revolving funds, it is self-reporting. HCD is not able to ensure when the funds will be used or that the accounts are maintained appropriately.

Criteria: According to 24 CFR 570.489(f)(1), “The State may permit units of general local government to establish revolving funds to carry out specific, identified activities. A revolving fund, for this purpose, is a separate fund (with a set of accounts that are independent of other program accounts) established to carry out specific activities which, in turn, generate payments to the fund for use in carrying out such activities.” Furthermore, 24 CFR 570.489(f)(3) states that, “A revolving fund established by either the state or unit of general local government shall not be directly funded or capitalized with grant funds.”

Cause: There is no process by which to verify the accounts or assess the local governments’ capabilities of continuing the revolving fund activities. HCD does not review bank statements, receipts, or withdrawals to validate reporting; it does not monitor for how local governments manage revolving funds; and it does not analyze and assess the extent to which the revolving funds will be used to continue the activities within the reasonably near future.

Additionally, according to the IDIS PR01 report based on data as of November 28, 2017, there is a balance of \$0 in RL funds. This was despite the state’s recognition of significant balances of revolving loan funds, for which they could not provide a specific amount, citing deficiencies in reporting by UGLGs.

Effect: Without sufficient oversight, CDBG Revolving Loan Funds have an increased likelihood of sitting in local government accounts for unspecified amounts of time. This increases the risks of local governments losing track of the CDBG funds and not using the funds in a timely manner for eligible activities fulfilling a national objective.

Corrective Action: The state must establish policies and procedures for determining when CDBG revolving loan fund activities are being carried out and if a local government has the capacity to use the funds appropriately and in a reasonable amount of time. The state must go back and audit the local governments’ CDBG revolving loan fund records and accounts to determine what should happen with each local government’s CDBG RL fund and the correct amount of RL that should be recorded in IDIS. Corrections must be made in IDIS accordingly so that the local governments’ RL fund accounts reconcile to IDIS rendering accurate reporting in IDIS.

Finding 6: There are insufficient internal controls in place to evidence program income in the state revolving fund (SF) is accurately reported in Integrated Disbursement Information System (IDIS) and used ahead of grant draws from the line of credit.

Condition: According to the IDIS PR01 report based on data as of November 28, 2017, there is a balance of \$12.1 million in state revolving funds (SF). Therefore, state of California Housing and Community Development (HCD) Department is reporting in IDIS that it is drawing line of credit funds before using local funds.

Criteria: According to 24 CFR 570.489(f)(2), “Program income in the revolving fund must be disbursed from the fund before additional grant funds are drawn from the Treasury for payments to units of general local government which could be funded from the revolving fund.” Pursuant to 24 CFR 570.490(a)(3), “The state shall make entries into IDIS in a form prescribed by HUD to accurately capture the state’s accomplishment and funding data, including program income.”

Cause: According to interviews with HCD staff, reconciliations were not performed between HCD’s accounts and IDIS. An effort was made in 2012-2013 to get program income into IDIS but it was not entered accurately. The most recent CDBG State Revolving Funds (SF) receipts were entered in IDIS with receipt #5080599 and receipt #5080610 on July 25, 2012 for a total of \$10.5 million. The last SF draw was voucher #1137549, on 06-26-13, IDIS Project #151, IDIS Activity #22374, Matrix Code 18A, for \$89,857.00 for County of Tehama - SF 18A, 2003 PI RLA SF 18A. Every line of credit draw against the EN fund (grant funds) made after June 26, 2013 supports the conclusion that California is drawing line of credit funds before using SF.

Effect: The state has insufficient records to ascertain if program income draws are occurring before grant draws from the line of credit funds and it is reporting erroneous information to HUD in IDIS.

Corrective Action: The state must establish policies and procedures for auditing its program income accounts and for periodically performing reconciliations with IDIS. The state must establish internal controls to ensure that decisions to perform draws from the line of credit are based on accurate program income information. Furthermore, the state must establish internal controls to ensure the information reported to HUD in IDIS is accurate. Ultimately, the state must go back through its program income accounts to determine the correct amount of SF that should be recorded in IDIS and make corrections in IDIS accordingly so that the state’s accounts reconcile to IDIS rendering accurate reporting in IDIS.

Area Tested: Timely Distribution

Finding 7: Grantee failed to expeditiously distribute uncommitted funds.

Condition: The state of California has not expeditiously obligated and announced awards to units of general local government using state uncommitted or recaptured funds from either unspent amounts on prior grant years or declined and rescinded grants.

Criteria: 24 CFR 570.494(b)(1) and (b)(2)

Cause: For an 11-year sample, 2005 through 2015, CAPES *CDBG Allocation Reports* indicated that contracts for CDBG allocations are \$49,406,092 less than the amount of those grants that was to have been awarded or disbursed pursuant to the annual timely distribution reports (HUD 40108), see the table below. When reviewers attempted to confirm this information, they found

that the state’s accounting department records reflect \$16,817,740 in uncommitted funds, which is \$32,588,352 less than CAPES reports reflected for those same years. Additional years were provided by the state accounting department, showing \$21,805,928 in uncommitted funds for grant years from 2003 to 2016.

Table: Reconciliation of Uncommitted Funds, 2005-2015 grants.

Federal Fiscal Year of Award	HUD 40108 - Expected UGLG Awards	CAPES - Current Allocation	HUD 40108 Awards LESS CAPES Allocation	HCD Accounting Department Reports - Uncommitted Amount
2005	\$ 45,327,542	\$ 14,664,780	\$ 30,662,761	\$ 193,381
2006	\$ 41,645,910	\$ 39,427,454	\$ 2,218,456	\$ 158,398
2007	\$ 40,158,445	\$ 38,986,676	\$ 1,171,769	\$ 648,259
2008	\$ 36,036,498	\$ 35,714,319	\$ 322,179	\$ 1,691,889
2009	\$ 38,222,182	\$ 37,904,892	\$ 317,290	\$ 183,124
2010	\$ 41,490,969	\$ 36,038,210	\$ 5,452,759	\$ 4,455,631
2011	\$ 34,492,216	\$ 30,984,991	\$ 3,507,225	\$ 3,798,420
2012	\$ 28,647,212	\$ 27,150,730	\$ 1,496,482	\$ 1,489,208
2013	\$ 29,041,975	\$ 28,220,807	\$ 821,168	\$ 821,168
2014	\$ 28,543,821	\$ 26,270,041	\$ 2,273,780	\$ 2,273,480
2015	\$ 27,481,526	\$ 26,319,303	\$ 1,162,223	\$ 1,104,782
11-Year Total	\$ 391,088,296	\$ 341,682,204	\$ 49,406,092	\$ 16,817,740
				Additional Years Provided by HCD Accounting Dept. Uncommitted Amount
			2003	\$ 77,675
			2004	\$ 1,136,300
			2016	\$ 3,774,213
			14-Year Total	\$ 21,805,928

The occurrence of uncommitted funding is exacerbated because the state is not considering local program income account balances when making grant awards. The local program income account balances are only later considered by the state when the unit of general local government is requesting draws and then required to draw program income first. Therefore, awards of grant funds are being disencumbered at higher than expected rates due to the lack of consideration of local program income before making awards.

Effect: The large balance of uncommitted funds means that the state is not disbursing all available CDBG funds to units of general local government in an expeditious manner.

Furthermore, the discrepancy between CAPES and the accounting department records may be preventing the state from properly taking these uncommitted funds into consideration when preparing the Annual Action Plans and subsequently the awards to units of general local government. Additionally, the state is disencumbering funds at a higher than normal rate due to the lack of accounting for locally-held program income before the grant fund award is made. Furthermore, not ensuring that all funds are appropriately awarded will contribute to the state's historically high unexpended balance to annual grant ratio.

Corrective Action: The state must provide a plan to HUD, within 60-days of the date of this letter, to expeditiously obligate and announce the funds outlined within this finding within 15 months from the date of this report.

Finding 8: Untimely distribution of 2016 funds.

Condition: The state failed to distribute all 2016 CDBG funds within 15 months of signing the grant agreement [less any allowable adjustments].

Criteria: 24 CFR 570.494(b)(1)

Cause: The state made the 2016 grant funds available to units of general local government via a 2016 NOFA. However, the NOFA was not designed to ensure that all 2016 grant funds would be obligated and announced to units of general local government by the 15-month distribution deadline, November 3, 2017. The state sets aside thirty percent of the CDBG award for economic development ED activities provided as "over the counter" applications. Any un-awarded ED funds are moved forward onto the next NOFA under the Community Development CD category. This occurred in 2016, and ED funding from the 2016 grant was added to the 2017 NOFA which had an application deadline of December 1, 2017 for CD funding, which was past the November 3, 2017 deadline to have obligated and announced the awards to local governments.

Effect: Failing to distribute State CDBG funds in a timely manner results in delays in program benefits to eligible low-and moderate-income beneficiaries. Furthermore, not ensuring that all funds are appropriately awarded is contributing substantially to the state's historically untimely ratio of unexpended balance to annual grant.

Corrective Action: The state must revise its policies to ensure that the full amount available to local governments is obligated and announced within 15 months of the state's signature on the annual grant agreement. The revised policies must be provided to HUD for review within 60 days of the date of this report, and must be included in the state's 2018 NOFA.

Area Tested: State PER and Overall Benefit Requirement

Finding 9: Failure to account for overall benefit and properly generate the State PER.

Condition: The state is not properly accounting for all CDBG funds, including program income, in determining:

1. Compliance with Overall Benefit, nor is the state selecting a compliance period,
2. Administration and planning cost caps, and
3. Public service cost caps.

Criteria: Overall Benefit: 24 CFR 570.484(b), State PER: 24 CFR 570.491, 24 CFR 91.520(a), and State PER Notice 16-10. State CDBG two-tier 20% administration and planning cost cap: 24 CFR 570.489(a)(3). Public service cost cap: 42 U.S.C. 5305(a)(8).

Cause: The state of California's internal reporting systems, as well as IDIS reporting, were incomplete and reporting practices were deficient and did not reinforce compliance.

The state generates a proprietary *financial summary* report for each grant, rather than using the IDIS version, the PR28. These financial summaries lack significant information. The state's report did not account for compliance with Overall Benefit, and did not indicate the selection of a compliance time-period from one to three years. The report also does not allow the state to ensure that the state is complying with the two-tier planning and administration cost caps for the 2015 and subsequent grants in 24 CFR 570.489(a)(3)(ii) and (iii). There is no reporting of the state administration cost match. Public service costs are included; however, the manner in which the report accounts for program income is not consistent with methodology to calculate compliance with these caps.

The state's *financial summaries* are compiled using Excel with data from two different sources. The grant financial information comes from the state's online reporting system, CAPES. The program income financial information is from an IDIS report for program income, the PR09.

For grant funds, the CAPES *CDBG Allocation Reports* have deficiencies which the state adjusts for when compiling the Excel-based grant *financial summaries*. These adjustments primarily relate to discrepancies between the state's accounting division records and those in CAPES. This discrepancy is especially notable in Finding 9 regarding the disbursement of disencumbered funds.

For program income, the IDIS PR09 reports are used to populate the state's *financial summaries*. However, using the PR09 report in this manner is inappropriate because the PR09 associates program income receipts and expenditures with program years in a manner that is inconsistent with the administration and planning cost caps in 24 CFR 570.489(a)(3), and public service cost cap. The administration and planning cost caps in 24 CFR 570.489(a)(3) provide that the state and its funded units of general local governments may not spend more than 20 percent of the aggregate amount of a CDBG grant, reallocated amounts, and any program income received during that program year. Any program income spent during that year counts towards that cap.

While, the PR09 associates program income with the year that the program income was received, program income expenditures reflected on the PR09 are recorded on a first-in, first-out basis against those receipts, rather than the program year in which the program income funds were spent.

Reliance on program income information from IDIS to compile the *financial summaries* is then causing the *financial summaries* to reflect the same deficiencies in program income reporting as noted in Findings 5, 6 and 7.

The state's policy on program income reporting is to only enter program income receipts into IDIS when a corresponding expenditure is also reported. Therefore, the receipts may not be recorded in IDIS in the same program year as their actual receipt by the unit of general local government, which may cause the administration and planning cost caps and public service cost caps to be miscalculated. Then, because the IDIS PR09 is used to generate the grants' *financial summaries*, those errors are repeated.

Effect: By not properly accounting for overall benefit, the two-tier administration and planning cost cap, and, the public service cost cap, the state's grant *financial summaries* are not sufficient to demonstrate that the state is compliant with these requirements.

Corrective Action: Given the deficiencies in the state's proprietary *financial summaries*, and the IDIS reporting and corrections that are being required in relationship to the corrective actions of other findings herein, the state shall bring IDIS reporting up-to-date in order to properly generate an IDIS *PR28 Financial Summary* for each open grant as part of the submission of the 2017 and subsequent program year's Consolidated Annual Performance Evaluation Reports (CAPER). The due date of the 2017 CAPER is September 28, 2018.

Area Tested: Annual Action Plan

Finding 10: Missing local program income account information in Annual Action Plan.

Condition: The state did not include the required information on local program income accounts and local revolving fund accounts in the Method of Distribution in the Annual Action Plan.

Criteria: 24 CFR 91.320(k)(1)(iv)

Cause: The state of California did not include a description of each of the local accounts including the name of the local entity administering the funds, contact information for the entity administering the funds, the amounts expected to be available during the program year, the eligible activity type(s) expected to be carried out with the program income, and the national objective(s) served with the funds.

Effect: By not including local program income and revolving fund account information in the Method of Distribution in the Annual Action Plan, the state is not providing the public necessary information regarding the availability of CDBG funds throughout the state for eligible activities.

Corrective Action: Given the proximity to the due date of the next plan, the state must include the information required by 24 CFR 91.320(k)(1)(iv) in the submission of the 2018 and subsequent Annual Action Plans.

Area Tested: Economic Development – Public Benefit Standard

Finding 11: The state demonstrated insufficient public benefit for certain economic development activities.

Condition: HUD reviewers identified the following 34 violations reported in IDIS for the state’s 2011 to 2016 program years:

- Twenty-one economic development activities that were reported to create or retain jobs exceeded the individual public benefit standard of \$50,000 per full-time equivalent (FTE).
- Ten additional activities exceeded the state’s stricter individual public benefit requirement of \$35,000 per FTE.
- Three activities exceeded the individual public benefit standard of \$1,000 per low- and moderate-income person to which goods or services are provided by the activity.

Criteria: 24 CFR 570.482(f)(4) provides that any activity subject to the public benefit standards which falls into one or more of the following categories will be considered by HUD to provide insufficient public benefit, and therefore may under no circumstances be assisted with CDBG funds: (i) The amount of CDBG assistance exceeds either of the following, as applicable: (A) \$50,000 per full-time equivalent, permanent job created or retained; or (B) \$1,000 per low- and moderate-income person to which goods or services are provided by the activity.

Title 25 of the California State CDBG regulations Article 2, section 7062.1(a)(1) codifies 24 CFR 570.482 to determine public benefit calculations for economic development projects. Section 7062.1(c)(6) further delineates the state’s requirements and lists the Allocation Review Procedures and Evaluation Criteria. Section 7062.1(a)(9)(B) defines the "Ratio of CDBG funds per job - maximum ratio of \$35,000 per job created or retained." Additionally, this requirement repeats in HCD’s annual funding NOFAs for the program years sampled.

Cause: The state is not ensuring that economic development activities meet the individual public benefit standard. Activities reported in IDIS clearly violate both HUD regulations and the state’s own requirements.

Table:
Economic Development Activities for Program Years 2011-2016 with Insufficient Public Benefit

Activities Reporting LMJ National Objective						
Activity ID	Activity Status	Proposed FTEs	CDBG Funding	CDBG Drawn	\$/FTE	
26119	Open	1	\$ 279,070	\$ -	\$ 279,070	
26090	Open	1	\$ 279,069	\$ -	\$ 279,069	
26075	Open	1	\$ 135,465	\$ -	\$ 135,465	
26067	Open	1	\$ 232,558	\$ -	\$ 232,558	
26061	Open	1	\$ 155,349	\$ -	\$ 155,349	
26013	Open	1	\$ 186,046	\$ -	\$ 186,046	

25934	Open	1	\$ 1,505,000	\$ -	\$ 1,505,000
25915	Open	1	\$ 279,069	\$ -	\$ 279,069
25711	Completed	1*	\$ 40,000	\$ 40,000	\$ 40,000
25670	Open	1	\$ 839,019	\$ 189,451	\$ 839,019
25314	Completed	1	\$ 40,250	\$ 40,250	\$ 40,250
25313	Completed	1*	\$ 57,500	\$ 57,500	\$ 57,500
25312	Completed	1*	\$ 40,250	\$ 40,250	\$ 40,250
25311	Completed	1*	\$ 80,500	\$ 80,500	\$ 80,500
24913	Completed	5	\$ 210,318	\$ 210,318	\$ 42,064
24687	Completed	9	\$ 333,500	\$ 333,500	\$ 37,056
24619	Completed	77	\$ 2,700,000	\$ 2,700,000	\$ 35,065
24453	Completed	4*	\$ 201,250	\$ 201,250	\$ 50,313
24438	Completed	8	\$ 296,675	\$ 296,675	\$ 37,084
24304	Completed	2**	\$ 105,880	\$ 105,880	\$ 52,940
24295	Completed	1*	\$ 82,974	\$ 82,974	\$ 82,974
24283	Open	5	\$ 247,315	\$ 202,685	\$ 49,463
24252	Completed	8	\$ 285,144	\$ 285,144	\$ 35,643
24175	Completed	3*	\$ 213,667	\$ 213,667	\$ 71,222
24090	Completed	1	\$ 60,000	\$ 60,000	\$ 60,000
24033	Completed	2	\$ 256,125	\$ 256,125	\$ 128,063
23826	Completed	2	\$ 150,993	\$ 150,993	\$ 75,497
23665	Completed	1	\$ 35,500	\$ 35,500	\$ 35,500
23582	Completed	2	\$ 102,567	\$ 102,567	\$ 51,284
22872	Completed	3	\$ 268,569	\$ 268,569	\$ 89,523
22856	Completed	6	\$ 306,938	\$ 306,938	\$ 51,156

Activities Reporting LMA National Objective
(goods or services made available to LMI persons)

Activity ID	Activity Status	LMI Persons	CDBG Funding	CDBG Drawn	\$/LMI Person
25942	Open	51	\$ 232,558	\$ -	\$ 4,560
26017	Open	1	\$ 279,070	\$ -	\$ 279,070
24059	Completed	1	\$ 182,403	\$ 182,403	\$ 182,403

TOTALS for LMJ and LMA \$ 10,700,591 \$ 6,443,139

* The public benefit standard is an element of activity eligibility. It is to be determined as criteria for award, as reflected by the proposed jobs counts entered into IDIS. With that said, it was encouraging that the indicated activities reported actual accomplishments that would result in less than \$35,000 per FTE created or retained.

** The state chose an inappropriate accomplishment type of “people” for the indicated activity, given the national objective and matrix code selections. See the IDIS Manual for State CDBG, Appendix C for more details.

<https://www.hudexchange.info/onecpd/assets/File/IDIS-for-State-CDBG-Manual-Appendices.pdf>

Effect: The state awarded \$10,700,591 in CDBG funds to UGLGs for economic development activities that did not meet the individual public benefit standards.

Corrective Action: The state will provide to HUD a copy of the original application and public benefit supporting documentation for the 34 activities. The state must also update the information reported in IDIS to match the state’s activity files, including, but not limited to, the proposed and final accomplishments and a complete activity description narrative. HUD will review the documentation provided before determining a final recommended repayment amount and any other corrective actions to ensure compliance in the future.

Area Tested: Benefit to Low- and Moderate-Income Persons on an Area Basis

Finding 12: LMA Reporting and Planning Activities

Condition: The National Objective of benefit to low- and moderate-income persons (LMI) on an area basis (LMA) is incorrectly reported for a significant number of activities, including planning-only activities.

Criteria: 24 CFR 570.483(b)(1)(i). An activity will be considered to address the objective of benefiting low- and moderate-income persons if the benefits of which are available to all the residents in a particular area, where at least 51 percent of the residents are low- and moderate-income persons. Such an area need not be coterminous with census tracts or other officially recognized boundaries but must be the entire area served by the activity. Units of general local government may, at the discretion of the state, use either HUD-provided data comparing census data with appropriate low- and moderate-income levels or survey data that is methodologically sound. An activity that serves an area that is not primarily residential in character shall not qualify under this criterion.

Cause: HUD reviewed 16 IDIS activities where the state reported an LMI percentage for the service area that did not match the HUD-provided data, from either the block group or the place data published by HUD and based on both the 2000 Decennial Census and the 2006-2010 American Community Survey (ACS) 5-year average. The 16 activities, including 7 planning-only activities, were reported by the state in IDIS to have met the national objective criteria, using HUD-provided data but, in each case, the maximum possible LMI percentage that could be determined from HUD-provided data was less than 51 percent.

Table: *IDIS Activities since July 2011, Reporting At Least 51% LMI and the Use of HUD-Provided LMA Data, But Not Matching HUD-Provided Data and Not At Least 51% LMI.*

Funded UGLG	IDIS Activity ID	Matrix Code	Drawn Amount	Initial Funding Date	Reported LMI Percentage	Highest Possible LMI% from HUD-provided Data
PLYMOUTH	22937	20A	\$ 100,000	4/9/2013	66.0	49.2

GROVER BEACH	23389	03J	\$	1,431,923	8/30/2016	54.4	49.4
GROVER BEACH	23390	20A	\$	31,800	9/9/2014	56.4	49.4
MOUNT SHASTA	23413	20A	\$	-	11/30/2017	56.0	46.5
EXETER	23664	03K	\$	40,000	10/22/2014	61.8	47.4
IMPERIAL	23755	03F	\$	40,000	11/14/2014	51.1	27.9
GUSTINE	23769	18A	\$	-	11/20/2014	59.3	40.4
SONORA	23806	03	\$	129,619	2/24/2015	66.8	50.6
PLYMOUTH	24055	20A	\$	41,326	3/12/2015	82.4	49.2
PLYMOUTH	24056	20A	\$	53,674	3/12/2015	82.4	49.2
YREKA	24087	20A	\$	8,750	3/25/2015	61.5	48.0
PLYMOUTH	24177	03J	\$	1,440,000	6/11/2015	65.9	49.2
AUBURN	24188	18A	\$	-	6/16/2015	54.5	33.6
SONORA	24849	03J	\$	1,395,349	4/7/2016	66.8	50.6
RIO DELL	25400	20A	\$	58,740	11/16/2016	60.3	48.1
LOS BANOS	25719	15	\$	173,501	7/25/2017	64.5	35.3
TOTAL \$				\$4,944,682			

HUD used database comparison techniques to review a total of 318 LMA activities reported by the state as funded in IDIS during program years 2011 through 2017. Because of the review methodology and data limitations, a number of other activities were not included in the table above. For example, the analysis excluded 98 activities (nearly a third of the sample) because the state reported non-existent or erroneous block group codes for the activity service areas in IDIS. Those activities are discussed further in Concern #3. The table above also excludes those activities where the state reported an UGLG name in IDIS that could not be matched with a place name in either the Census or ACS datasets. Non-matching text occurred most frequently where the reported UGLG in IDIS was a county.

Effect: The state awarded \$4,944,682 in CDBG funds to UGLGs for activities that did not meet the national objective criteria based on area benefit.

Corrective Action: The state will provide HUD of the original application and national objective supporting documentation for the 16 activities. Where possible, the state should correct the IDIS entries for area benefit. Guidance on the HUD-provided datasets and reporting LMA benefit in IDIS is provided in *CPD Notice 14-10 Transition Policy for LMISD Updates during FY 2014 for the State CDBG Program*. A possible correction may be that the National Objective compliance was based upon a local income survey rather than HUD-provided data; in which case, the state must provide the local survey information to HUD along with the original application, and correctly report such activities in IDIS by selecting *Survey*, rather than *Census* on the activity set-up screen. HUD will review the documentation provided before determining a final recommended repayment amount and any other corrective actions.

Area Tested: State's Reviews and Audits

Finding 13: The state is not performing required reviews and audits, including on-site reviews, of units of general local government (subgrantees).

Condition: The state is not carrying out monitoring of CDBG-funded activities in accordance with its own policies and procedures.

Section 7110(f) and (g) of title 25 of the California Code of Regulations says that the state will make site visits of its subgrantees to review program accomplishments and management control systems, and to provide program assistance. Additionally, section 7110 provides that the state will review each subgrantee's performance to determine whether the subgrantee has carried out the program as described in its application, the program complies state program rules and other applicable laws and regulations; and subgrantee has the continuing capacity to complete the approved program according to time schedules approved by the state.

Chapter 12 of the California Grants Management Manual sets forth the CDBG Grant Monitoring Handbook. It provides that the state shall identify grantee training needs by analyzing monitoring data. To increase local grant management capacity and provide relevant technical assistance, training will be targeted to address the most common challenges revealed in monitoring. Chapter 12 also provides that monitoring may include on-site visits to the local government's offices or desk monitoring's at HCD. On-site monitoring will be based on annual risk assessments. Planning and Technical Assistance (PTA) grants will be desk monitored. Chapter 12 of the Manual establishes the state's responsibilities to HUD "to ensure all CDBG funds are used in accordance with federal regulations" and includes the state's goal "to help grantees comply with these federal regulations, as well as all state statutes and requirements, and to help resolve problems in the implementation of their CDBG program activities." Further the state's manual indicates that "Monitoring is the primary tool HCD uses to ensure this compliance. Monitoring is also an opportunity to provide focused, specific technical assistance and guidance based on evaluation of a jurisdiction's processes and practices. Whenever possible, deficiencies will be rectified through discussion, negotiation and technical assistance."

The state provided HUD with a spreadsheet of recent desk monitoring and on-site visits of subgrantees. The spreadsheet indicated only six desk or site visit monitoring's since 2014 (City of Portola, City of Nevada City, and City of Del Norte in 2015, City of Nevada City in 2016, City of Lincoln and City of Colusa in 2017). The summary spreadsheet including a column, "reason for review," that did not in any way link to annual risk assessments required by the state's own policies and procedures in Chapter 12 of the Grants Management Manual.

Criteria: 24 CFR 570.492 requires the state to make reviews and audits including on-site reviews, of subgrantees as may be necessary or appropriate to meet the requirements of section 104(e)(2) of Title I. The state's review must determine whether subgrantees have satisfied applicable performance criteria, including whether the subgrantees carried out activities and, where applicable, housing assistance plans in a timely manner, carried out activities and certifications in accordance with program requirements and with other applicable laws, and whether subgrantees have continuing capacity to carry out those activities in a timely manner. Additionally, the state shall establish remedies for noncompliance by subgrantees and shall take appropriate actions to prevent continued deficiency, mitigate any adverse effects or consequences and prevent recurrences of noncompliance.

24 CFR 570.492 also requires reviews and audits "necessary or appropriate" to meet the requirements of section 104(e)(2). Section 104(e)(2) requires HUD to make annual audits and

performance reviews of the state, including “whether the State has made such reviews and audits of the units of general local government.”

Cause: The state indicated in interviews with HUD that it does not have sufficient funds to undertake a thorough monitoring program.

Effect: This is a fundamental failure of the state of California’s responsibility to ensure that CDGB funds are expended for eligible activities. The state’s limited monitoring is not done in accordance with any schedule, does not reflect a risk assessment in accordance with its policies and procedures, and is insufficient to determine compliance with HUD program requirements and applicable laws. The state’s reviews of subgrantees are insufficient to determine the subgrantees’ continuing capacity to expend funds in a timely manner. Further, the state’s reviews are insufficient to meet its own policy that subgrantee monitoring will inform its technical assistance and training.

Corrective Action: The state must complete its annual risk assessments of its subgrantees and develop a monitoring strategy for the current year that reflects its risk assessments and policies and procedures. In addition, the state should make changes to its policies and procedures to reflect current practice as necessary. Policies, procedures and actions must reflect adequate monitoring to meet the requirements of section 104(e)(2) and 24 CFR 570.492(a).

Area Tested: Subgrantee Closeouts

Finding 14: Grant closeouts are not conducted in a timely manner

Condition: The state did not ensure the timely closeout of grants to units of general local government. While the state has written closeout policies and procedures, it does not actively manage grants to implement the closeout process under these policies and procedures. State reports showed that for the period 2011 to 2015 that it awarded 202 contracts. Of that number, one contract was shown completed and 112 had all funds expended. At a minimum, the state should have initiated closeouts for grants with a zero balance. There were also several grants that were expired, or had no updated contract status. The state’s Grants Management Manual advises grantees to submit Financial and Accomplishment Reports within 30 days of the expiration of the grant.

Eight contracts were selected for examination from the CDBG program. Four of the eight projects had zero balances. The other four projects were at various stages of completion. Only one of the eight contracts, the City of West Sacramento, submitted documents to closeout its grant. The state’s CAPES information system tracks the status of grants within HCD. The Contracts Management Section uses a management-developed spreadsheet for tracking the status of contractor activity (e.g., amendments and invoices) within the Section. However, this spreadsheet only captures activity for which an action has been requested. It does not cover the whole universe of grants and the associated status. Therefore, only a small number of grants are shown for which actions should be taken. For instance, grantees that have zero balances or expired grants could be potentially closed out.

CAPES indicated that the City of San Joaquin #11-PTEC-7639 (CDBG), planning and technical assistance grant was expired and closed, but there was no indication that the funds had been disencumbered. It was also unclear whether program accomplishments had been met, as over half of the funds were remaining and no work product was included in the file, nor was there an indication that the activity was discontinued.

The City of West Sacramento submitted documents to closeout its grant and funds were disencumbered. However, there was no indication that the checklist used to closeout the grant was in the file and that state staff had actively reviewed or confirmed that the grant was formally closed out.

Five files were examined from the CDBG-DR 2008 Ike grant. Approximately 27% of the CDBG-DR funds allocated to the state in response to fires in 2008 remains unspent at this time. Project files included 10-DRI-6793 (County of Trinity), 10-DR-6788 (Plumas County), 10-DRI-6794 (Yurok Tribe), 10-DRI-6785 (Butte County and DR-11-773 (Mendocino County). Of the five, one contained all of the closeout document required by the state's Policies and Procedures manual, three contained partially complete closeout material and one contained a note to staff to request the material from the subgrantee at some future date. Consistent with the comments below, monitoring of the grants was intermittent at best with no files containing evidence of consistent monitoring by state staff; the state does not follow its administrative requirements for closeout, and the state fails to act in a timely manner to execute closeout of its 2008 grant awards.

Criteria: 24 CFR 570.489(i) requires the state to establish requirements for timely closeout of grants to units of general local government and act to ensure the timely closeout of such grants. CPD Notice 14-02 provides instructions for implementing the closeout of grants.

Cause: The state did not adequately implement its written closeout policies and procedures. There was a lack of active program/contract management, high staff turnover, and inadequately trained staff to oversee the closeout process.

Effect: The timely closeout of grants impacts the state's ability to expend funds in a timely manner. Unexpended grant balances that are not recaptured are not available for reuse until they have been disencumbered and made available for new activities. Closeouts outline the conditions for the use of program income, the change of use for real property, and record retention requirements. The process also confirms the eligibility of activities, compliance with national objectives, overall benefit, and program performance. Further, it confirms the use of funds in the annual PER and compliance with program administration cap, public service cap, and program administration match. Closeouts also ensure all outstanding monitoring and audit findings have been addressed.

Corrective Action: The state should review each open contract to determine its status. For those contracts with zero balances, closeout procedures should be initiated to ensure grant funds were eligible, met a national objective, and provided appropriate performance. Grants that have expired should be evaluated to determine whether extensions are appropriate, and management plans for the use of these funds be developed. If not, the state should recapture remaining funds,

and determine whether program requirements and objectives have been met. If not, further appropriate action might need to be taken, including but not limited to repayment of funds.

Area Tested: Accountability for Real Property

Finding 15: The state is not implementing accountability requirements for real and personal property.

Condition: The state does not keep an inventory of real or personal property acquired with CDBG funding, or other means of demonstrating compliance with 24 CFR 570.489(j) and (k). Pursuant to 24 CFR 570.489(k), states are required to establish and implement requirements on the use, management, and disposition of real and personal property acquired with CDBG funds, of which an inventory is a basic requirement. Additionally, these requirements must ensure compliance with the change-of-use provisions at 24 CFR 570.489(j).

Criteria: 24 CFR 570.489(k) *Accountability for real and personal property.* The state shall establish and implement requirements, consistent with state law and the purposes and requirements of this subpart (including paragraph (j) of this section) governing the use, management, and disposition of real and personal property acquired with CDBG funds. 24 CFR 570.489(j) *Change of use of real property.* The standards described in this section apply to real property within the unit of general local government's control (including activities undertaken by subrecipients) which was acquired or improved in whole or in part using CDBG funds in excess of the threshold for small purchase procurement (2 CFR 200.88). These standards shall apply from the date CDBG funds are first spent for the property until five years after closeout of the unit of general local government's grant.

(1) A unit of general local governments may not change the use or planned use of any such property (including the beneficiaries of such use) from that for which the acquisition or improvement was made, unless the unit of general local government provides affected citizens with reasonable notice of and opportunity to comment on any proposed change, and either:

- (i) The new use of the property qualifies as meeting one of the national objectives and is not a building for the general conduct of government; or
- (ii) The requirements in paragraph (j)(2) of this section are met.

(2) If the unit of general local government determines, after consultation with affected citizens, that it is appropriate to change the use of the property to a use which does not qualify under paragraph (j)(1) of this section, it may retain or dispose of the property for the changed use if the unit of general local government's CDBG program is reimbursed or the State's CDBG program is reimbursed, at the discretion of the state. The reimbursement shall be in the amount of the current fair market value of the property, less any portion of the value attributable to expenditures of non-CDBG funds for acquisition of, and improvements to, the property, except that if the change in use occurs after grant closeout but within 5 years of such closeout, the unit of general local government shall make the reimbursement to the state's CDBG program account.

(3) Following the reimbursement of the CDBG program in accordance with paragraph (j)(2) of this section, the property no longer will be subject to any CDBG requirements.

Cause: The state does not keep an inventory of real or personal property acquired with CDBG funding, or other means of demonstrating compliance with 24 CFR 570.489(j) and (k). The procedures in HCD's Grants Management Manual, checklists, and other closeout documents do not appear to distinguish between activities involving real property and other activities. In interviews with state staff, they indicated that CAPES system can identify and differentiate between activities involving acquisition and improvement of real properties that are within the control of the state and its subgrantees, but that the state had not developed a process to gather this information into a report that is periodically reviewed. Furthermore, the state did not implement closeout procedures that adequately addressed real property acquired with CDBG funds. Lastly, because closeouts of local government awards are not occurring in a timely manner, see Finding 14, the change-of-use requirements can remain in effect indefinitely, causing increased risk of further noncompliance.

Effect: The state is not implementing accountability requirements for real and personal property, failing to comply with 24 CFR 570.489(k). Furthermore, due to failure to implement these requirements, the state is not able to demonstrate compliance with the change of use requirements, pursuant to 24 CFR 570.489(j).

Correction Action: The state shall update its real and personal property requirements to comply with 24 CFR 570.489(k). The updated requirements shall be provided to HUD.

The state shall notify the UGLGs of the applicability of CDBG requirements on real property, work with UGLGs to build and validate a real property inventory and begin closing out UGLG grants so that the requirements of 24 CFR 570.489(j) are not applicable indefinitely. The state shall also conduct a review of compliance with 24 CFR 570.489(j) for all UGLG awards which are currently open or closed out within 5 years of this monitoring letter, and which involved or were likely to involve the acquisition of real property. A detailed report of this review will be provided to HUD and shall include property-specific information that is sufficient to determine compliance with 24 CFR 570.489(j). The state is reminded that reimbursements for change-of-use shall be in the amount of the current fair market value of the property, less any portion of the value attributable to expenditures of non-CDBG funds for acquisition of, and improvements to, the property.

Concern(s)

Concern 1: Confusion over Adjusted Income Limits

Condition: UGLGs may be using the wrong income limits.

Cause: The state has two sets of income limits: 1) an adjusted set for state-funded programs; and 2) HUD Section 8 income limits for the CDBG program. However, the state's CDBG Grant Management Manual and NOFA Appendices were not specific about which income limits to use. For example, the state's 2017 NOFA, Appendix H indicates, "To access the latest available Income Limits, click on this hyperlink [<http://www.hcd.ca.gov/grants-funding/income-limits/state-and-federal-income-limits.shtml>]," and on that webpage, both sets of income limits are published.

Effect: The state’s adjusted income limits are generally higher than the HUD limits. Therefore, any grantee erroneously using the state’s version could be determining persons to be LMI who are not, which would bring into question the National Objective determinations for jobs, housing, clientele, and area-benefit where surveys are conducted.

Recommended Action: The state should clarify the income limit references in the state’s CDBG Grant Management Manual and annual NOFAs.

Concern 2: LMA Reporting and Planning Activities

Condition: The state may not be properly determining National Objective compliance for planning-only activities. Additionally, LMA does not appear to be correctly reported for a significant number of activities, including planning-only activities.

Cause: During the monitoring review, the state of California, Department of Housing and Community Development (HCD) staff asked HUD reviewers how to appropriately determine national objective compliance for planning-only activities. Although, HUD reviewers did not specifically sample planning-only activities while on-site, some significant concerns were raised in a review of materials available in IDIS and on the HCD website. The review follows a thread, which reveals specific issues at each step in the thread; although discrete activities are being discussed, the concerns may relate to systemic issues.

The state’s published 2011-2012 *Planning and Technical Assistance (PTA) Allocation* http://www.hcd.ca.gov/grants-funding/nofas/docs/PTA_General_and_Economic_Development_Allocations_1112.pdf referenced four tourism-related planning activities. Tourism-related activities are often suspect. While potentially creating jobs, tourism would not generally fulfill other National Objectives, such as area benefit. Subsequent years’ lists of awards published online by the state lacked a subject description of the planning activities; therefore, only the 2011-2012 list was reviewed in the context of tourism planning. The four tourism-related \$35,000-awards were:

- County of Butte,
- City of Mount Shasta,
- County of Siskiyou, and
- City of Yreka.

The City of Yreka’s \$35,000 grant award for tourism-related planning was chosen for further investigation. This award would appear to relate to 4 IDIS activities based on IDIS-reported references to the contract number “11PTEC7648”:

- #22658- National Objective: LMJ and Matrix code: 20A. This activity has \$33,250.00 in grant funds drawn, and an accomplishment narrative indicating that the plan would “create 32 jobs and retain 574 jobs”,
- #22659- Matrix code: 21A, administration. This activity has \$1,750 in grant funds drawn,
- #24087- National Objective: LMA, with 61.5% LMI reported, Matrix code: 20A. This activity has \$8,750 in program income drawn, and an accomplishment narrative referencing “2504 accomplishments”, and

- #24086- Matrix code: 21A, administration. This activity has \$1,894 in program income drawn.

Because these four activities are presumably related to Yreka's one tourism marketing plan, the inconsistent reporting of the national objective as both LMJ and LMA is concerning:

LMJ for Activity #22658: The contract number, 11PTEC7648, entered by the state in IDIS for this activity was also referenced in the town of Yreka's online publication of the Strategic Tourism Marketing Plan, https://ci.yreka.ca.us/sites/ci.yreka.ca.us/assets/files/Yreka_Strategic_Tourism_Marketing_Plan.pdf. However, that published version of the plan only makes general references to the job market, and does not discuss creating or retaining jobs specifically for low- and moderate-income persons, which raises concerns that the LMJ National Objective would not be met if the plan was actually implemented, which is the criteria for planning-only activities pursuant to 24 CFR 570.483(b)(5). Furthermore, the basis for indicating that implementation of the plan would create 32 jobs and retain 574 is not supported by the published plan.

LMA for Activity #24087: The use of LMA for tourism-related activities is suspect due to the nature of tourism and the requirements for the LMA National Objective. LMA requires that the benefits of activities be available to all the residents in a particular area, where at least 51 percent of the residents are low- and moderate-income persons. Whereas, the nature of tourism-related activities is to serve and attract clientele from outside the local area. The use of LMA is also suspect because of the inconsistency with Activity #22658 which references the same contract, but is reported as LMJ, not LMA. Nevertheless, the reported LMA data for this activity was reviewed, raising further concerns still. The reported LMI for the selected block groups appropriately corresponds to the 61.5% LMI (2000 Census-based LMI data). However, the reason why the particular block groups were selected by the state is less clear. The City of Yreka was only 48% LMI for the place-level geography, which raises questions about the selection of these particular block groups to create a service area of 61.5% LMI. The selected block groups were 060930007021, 060930007022, and 060930007031 (i.e. tract 7.02 block groups 1 and 2, and tract 7.03 block group 1) which only cover an area to the east and the southern half of the City itself. It would appear that the service area was delineated in order to achieve a qualifying LMI percentage rather than to appropriately represent the residential area that would benefit from the activity.

Further data review revealed two planning-only activities in IDIS for which the service area was inappropriately reported to be 100% LMI. The City of Corning, activity #22875, was 53.7% LMI according to HUD's place-level data based on the 2000 Census, despite being reported in IDIS as 100% LMI with HUD-provided data. Additionally, the County of Amador, activity #24683, was reported by the state to have a service area of 100% LMI according to HUD-provided data; however, no place-level or block group-level data for anywhere within the County could result in a service area of 100% LMI.

Based on the selected planning-only activities with LMA percentages that appear to be misrepresented, HUD reviewers expanded the IDIS data review to include all LMA activities with funding information entered into IDIS since July 1, 2011. In this sample, 23 activities were

found to have reported the use of HUD-provided data, yet entered 100% LMI, which would not be possible given the HUD-provided data.

Table: *IDIS Activities Since July 2011, Appearing to Erroneously Report Service Areas as 100% LMI.*

Funded UGLG	IDIS Activity ID	Matrix Code	Drawn Amount	IDIS Funding Date
FORT JONES	19232	03O	\$ 42,402	9/22/2011
NEVADA CITY	22870	03K	\$ 92,500	4/12/2013
CORNING	22875	20A	\$ 94,761	3/22/2013
FORT BRAGG	24059	18A	\$ 182,403	3/17/2015
CORNING	24588	03K	\$ -	2/29/2016
AMADOR COUNTY	24683	20A	\$ 94,953	3/17/2016
SHASTA LAKE	24756	03J	\$ 1,116,279	2/12/2016
TRINITY COUNTY	24781	03O	\$ 72,906	3/2/2016
ANDERSON	24941	03J	\$ 709,891	7/22/2016
CORNING	25628	03K	\$ 459,356	5/4/2017
MONO COUNTY	25898	03F	\$ 3,885	11/13/2017
LAKE COUNTY	25917	03K	\$ -	11/30/2017
LASSEN COUNTY	25923	03J	\$ -	11/30/2017
COLUSA	25937	18A	\$ -	11/30/2017
EL DORADO COUNTY	25949	18A	\$ -	11/30/2017
PLYMOUTH	25970	03J	\$ -	11/30/2017
YOLO COUNTY	25983	03J	\$ -	11/30/2017
SOUTH LAKE TAHOE	25999	18C	\$ -	11/30/2017
WILLIAMS	26017	18A	\$ -	11/30/2017
HOLLISTER	26020	03	\$ -	11/30/2017
HURON	26029	03J	\$ -	11/30/2017
ORANGE COVE	26121	15	\$ -	12/1/2017
MONTAGUE	26125	03	\$ -	12/1/2017
		TOTAL	\$ 2,869,336	

Additionally, the following 98 activities had service areas reported with census block group codes that either had errors or did not exist in either the 2000 Decennial Census or 2006-2010 American Community Survey data. These activities had funding reported in IDIS since July 1, 2011 and were reported to be referencing the HUD-provided data. The validity of the reported LMI percentage could not be verified due to these reporting errors.

Table: *IDIS Activities since July 2011, Reporting Incorrect or Nonexistent Block Group Codes.*

Funded UGLG	IDIS Activity ID	Matrix Code	Drawn Amount	IDIS Funding Date
FORT JONES	19232	03O	\$ 42,402	22-Sep-11

YREKA	20786	20A	\$	66,500	13-Mar-12
FIREBAUGH	22124	20A	\$	62,061	10-May-12
WASCO	22293	20A	\$	5,598	12-Jul-12
CRESCENT CITY	22299	20A	\$	65,322	13-Jul-12
FORT BRAGG	22307	20A	\$	33,250	13-Jul-12
MARICOPA	22318	20A	\$	-	13-Jul-12
LINDSAY	22702	03K	\$	182,265	15-Nov-12
LINDSAY	22704	05V	\$	60,969	15-Nov-12
LINDSAY	22706	03L	\$	60,419	16-Nov-12
LINDSAY	22707	03N	\$	61,438	16-Nov-12
LINDSAY	22708	05V	\$	60,010	16-Nov-12
LINDSAY	22709	03N	\$	45,240	16-Nov-12
LINDSAY	22710	03N	\$	45,093	16-Nov-12
LINDSAY	22711	03K	\$	78,590	16-Nov-12
LINDSAY	22712	03F	\$	1,746,325	16-Nov-12
LINDSAY	22713	03F	\$	232,462	16-Nov-12
LINDSAY	22714	03I	\$	90,309	16-Nov-12
LINDSAY	22716	03	\$	30,420	16-Nov-12
LAKE COUNTY	22746	03K	\$	-	12-Dec-12
LAKE COUNTY	22748	20A	\$	-	12-Dec-12
ORANGE COVE	22798	03J	\$	-	11-Apr-13
ORANGE COVE	22799	20A	\$	-	11-Apr-13
CALIMESA	22837	20A	\$	39,871	14-Feb-13
MARIPOSA COUNTY	22890	03J	\$	23,939	09-Apr-13
TEHAMA COUNTY	22962	20A	\$	49,970	16-Apr-13
LINDSAY	23002	03K	\$	33,300	14-May-13
LINDSAY	23003	05V	\$	11,655	15-May-13
LINDSAY	23004	03L	\$	10,545	15-May-13
LINDSAY	23006	03F	\$	210,900	15-May-13
WILLOWS	23531	20A	\$	57,406	11-Aug-14
COLUSA COUNTY	23616	03	\$	250,000	15-Oct-14
WINTERS	23713	18A	\$	76,080	04-Nov-14
FORT BRAGG	24059	18A	\$	182,403	17-Mar-15
OROVILLE	24126	15	\$	155,244	05-May-15
OROVILLE	24127	03	\$	135,422	05-May-15
OROVILLE	24132	15	\$	181,975	06-May-15
OROVILLE	24133	03	\$	120,832	06-May-15
OROVILLE	24134	03	\$	24,853	06-May-15
OROVILLE	24135	03	\$	62,184	06-May-15
OROVILLE	24139	15	\$	54,693	06-May-15
OROVILLE	24140	04	\$	12,933	06-May-15
ANDERSON	24180	03J	\$	15,948	15-Jun-15
SHASTA LAKE	24412	20A	\$	93,023	03-Nov-15

WASCO	24449	20A	\$	64,973	06-Oct-15
LIVINGSTON	24597	03J	\$	1,435,102	29-Apr-16
LIVE OAK	24799	20A	\$	44,875	14-Mar-16
IMPERIAL COUNTY	24824	03J	\$	506,429	23-Mar-16
IMPERIAL COUNTY	24825	03J	\$	626,918	23-Mar-16
IMPERIAL COUNTY	24826	05V	\$	117,974	23-Mar-16
IMPERIAL COUNTY	24827	05V	\$	94,387	24-Mar-16
WILLIAMS	24840	03J	\$	957,404	30-Mar-16
ANDERSON	24941	03J	\$	709,891	22-Jul-16
MONTAGUE	25045	20A	\$	27,446	15-Aug-16
Grover Beach	25215	20A	\$	61,223	21-Sep-16
OROVILLE	25372	03	\$	581,599	24-Oct-17
MADERA COUNTY	25411	20A	\$	27,483	01-Dec-16
MADERA COUNTY	25412	20A	\$	28,282	01-Dec-16
TULELAKE	25447	03J	\$	656,692	22-Dec-16
TULELAKE	25452	03F	\$	353,078	22-Dec-16
ANGELS CAMP	25510	03F	\$	135,841	07-Feb-17
IMPERIAL COUNTY	25515	05V	\$	47,243	08-Feb-17
NEVADA COUNTY	25540	20A	\$	47,478	17-Feb-17
IMPERIAL COUNTY	25557	05V	\$	58,934	10-Mar-17
TULARE COUNTY	25588	03O	\$	339,894	06-Apr-17
WOODLAKE	25619	15	\$	32,603	25-Apr-17
FIREBAUGH	25687	03J	\$	965,331	14-Jun-17
IMPERIAL COUNTY	25690	05V	\$	103,423	14-Jun-17
TEHAMA COUNTY	25786	03I	\$	952,502	20-Sep-17
DEL NORTE COUNTY	25916	03L	\$	-	30-Nov-17
LAKE COUNTY	25917	03K	\$	-	30-Nov-17
LASSEN COUNTY	25923	03J	\$	-	30-Nov-17
SONORA	25924	20A	\$	-	30-Nov-17
SUSANVILLE	25929	03	\$	-	30-Nov-17
COLUSA	25937	18A	\$	-	30-Nov-17
ANGELS CAMP	25939	03O	\$	-	30-Nov-17
UKIAH	25942	18A	\$	-	30-Nov-17
UKIAH	25945	18C	\$	-	30-Nov-17
EL DORADO	25949	18A	\$	-	30-Nov-17
COUNTY					
CALAVERAS	25951	05W	\$	-	30-Nov-17
COUNTY					
CALAVERAS	25954	20A	\$	-	30-Nov-17
COUNTY					
GLENN COUNTY	25956	03E	\$	-	30-Nov-17
IMPERIAL COUNTY	25963	03J	\$	-	30-Nov-17
IMPERIAL COUNTY	25965	03O	\$	-	30-Nov-17
IMPERIAL COUNTY	25966	05M	\$	-	30-Nov-17

IMPERIAL COUNTY	25969	20A	\$	-	30-Nov-17
PLYMOUTH	25970	03J	\$	-	30-Nov-17
KINGS COUNTY	25975	03L	\$	-	30-Nov-17
SAN BENITO COUNTY	25979	03	\$	-	30-Nov-17
YOLO COUNTY	25983	03J	\$	-	30-Nov-17
TUOLUMNE COUNTY	25992	03J	\$	-	30-Nov-17
SOUTH LAKE TAHOE	25999	18C	\$	-	30-Nov-17
WILLIAMS	26017	18A	\$	-	30-Nov-17
HOLLISTER	26020	03	\$	-	30-Nov-17
FORT BRAGG	26021	03J	\$	-	30-Nov-17
CALAVERAS COUNTY	26033	14H	\$	-	30-Nov-17
ORANGE COVE	26121	15	\$	-	01-Dec-17
MONTAGUE	26125	03	\$	-	01-Dec-17
		TOTAL	\$		13,748,854

Effect: These issues are reported as concerns rather than findings for two reasons. In the case of the planning-only activity in the City of Yreka, although the information reported in IDIS is highly suspect, the state’s files were not reviewed by HUD while on-site. In the case of the activities erroneously reported in IDIS as 100 percent LMI and the activities with errors in the block group codes, the HUD reviewers were not able to correlate the reported service areas to HUD-provided data to demonstrate that the actual LMI percentage was less than 51 percent. Therefore, while the reporting errors are obvious, a failure to fulfill a national objective was not firmly established using IDIS data, and the state’s files were not reviewed by HUD while on-site. However, the state is cautioned that if these issues were to also be reflected in the state’s files, then several significant findings would be warranted for misrepresentation of National Objective compliance.

Recommended Action: The state should review its policies and procedures for funding planning only activities to ensure they are compliant with CDBG regulations. Furthermore, the state should correct the IDIS entries for area benefit to match the data reported by the UGLG in the state’s activity files. Those activities reported to be 100 percent LMI, in contradiction to the HUD-provided data, should be corrected. Additionally, the reported block group codes should be corrected and reviewed for National Objective compliance. A possible correction may be that the National Objective compliance was based upon a local income survey rather than HUD-provided data; in which case, the state should select *Survey*, rather than *Census* in IDIS. If the state finds that these activities did not meet a National Objective, the state may proactively provide a remedy to HUD.

Concern 3: Administratively Burdensome Program Income Policies.

Condition: The state’s *Program Income (PI) Reuse Agreement* is administratively burdensome for the state. The *Program Income (PI) Reuse Agreement*, dated July 2015, is published at

Cause: HUD reviewers provided comments to a number of specific policies in the *Program Income (PI) Reuse Agreement* for the state's consideration:

- a. On page 2, under *Receipt of Program Income*, item 3 indicates that "If repayment comes from a loan or asset that was originally paid with CDBG and non-CDBG funds, the PI accounting and reporting must reflect the correct amounts and proportions of CDBG PI and non-CDBG funds invested in the asset. Only the CDBG portion of the repayment is deposited into one of the three PI accounts." This policy is not clear that the CDBG portion of such repayments shall be prorated to reflect the percentage of CDBG funds used, as noted in 570.489(e)(1). For example, total income from rents or resale will often exceed the amount of the CDBG investment, including acquisition costs and subsequent investment for rehabilitation; consequently, the program income attributed to CDBG on a pro rata basis will often exceed the amount of the CDBG invested.
- b. On page 4 and 5: The state's program income *PI Waiver* process has limitations, such as:
 - 1) The state limits waiver projects to only 2 active projects at a time. This provision appears again on page 8. This limitation may be slowing expenditures by UGLGs.
 - 2) The state mandates that a PI Waiver project can only be approved if the total project or program cost for the proposed activity is on hand in the Jurisdiction's PI account. The state does not allow future receipts of PI to be committed for PI Waiver projects. If the UGLG has a reliable source of regular program income deposits, it should be allowed to budget accordingly. Ultimately, they will be required to draw program income ahead of grant funds, and ignoring incoming program income deposits during budgeting for PI waiver applications would impose an unnecessary limitation. This requirement by the state is mirrored on Page 15 item 7, which indicates that sufficient PI must be on hand for the full PI waiver activity costs. Again, this doesn't account for consistent sources of program income to considered in the budget.
 - 3) The state requires that the undersigned jurisdiction, the UGLG, understand that if it receives a subsequent award of CDBG funds, upon execution of the new grant contract all waiver activities are to be completed first, after which, PI must be expended first on the active grant contract activities. The state indicates that PI Waivers will not be included in the grant, because Supplemental activities will be included in contracts. This requirement is unnecessary. Program income must be expended ahead of grant funds, whether it be for the awarded activity or the supplemental activity.
- c. On page 7, under *Transfer of program income to Entitlement program*, the state lists the requirements for maintaining an RLF pursuant to State CDBG regulations. However, the state is not clear about the requirements for transferring an RLF from under the state program to the entitlement program.
- d. On page 11, item I, the state indicates that "each housing activity is required to be approved by the Department for use under the RLF." Because the RLF fund itself must

be approved by the state, the UGLG must agree to the CDBG terms, and the state is subject to monitoring requirements; it may be unnecessary and administratively burdensome for the state to approve each housing activity under an RLF. Additionally, the state's approval of specific activities under an UGLG's RLF is not required by CDBG regulations.

- e. On page 11, item 6, the state indicates that "RLF program activities that are also funded under an active contract, but limited to only grants to projects, will not require RLF funds to be spent first on the active grant activities." It is not clear if the state's intention with this requirement is consistent with CDBG regulations. The state may supplement RLF activities with CDBG grant funds when RLF fund balances are insufficient to fund an activity; however, the RLF funds are program income and are required to be expended ahead of grant funds. Although CDBG grant funds may be used, the RLF must be designed to generate payments to the fund; therefore, the beneficiary would not be receiving a grant from an RLF.
- f. On page 12, item 9, the state indicates that "RLF PI balances will not be moved to another approved RLF account or to the Jurisdiction's regular PI account. The Department may use a state or federal disaster declaration to formally allow for re-purposing of PI funds by the Jurisdiction. Funds approved by the Department for re-purposing to meet an urgent need are considered PI and must be expended first under active grant contracts or under approved waivers, if there is no active contract." The state may consider expanding the circumstances to allow the re-purposing of RLF funds when RLF balances exceed the market demand for the types of loan products offered.
- g. On page 12, item 18, HUD reviewers questioned the intent of the use of the term "citizens." It may have been the state's intent to refer to "residents."
- h. On page 15, item 10, the state indicates that "PI Waivers will not be approved for the same program activities for approved RLFs." The state may consider allowing UGLGs to reprogram general program income to the RLF when RLF funds are insufficient to cover the costs of the next activity. This may assist in the expeditious expenditure of PI.
- i. On page 16, item B, the state requires UGLGs with PI on hand and have not applied for or been awarded CDBG funds within the past three NOFAs to submit a PI Expenditure Plan for PI on hand. If the UGLG does not respond to the state's request that a PI Expenditure Plan be submitted, the UGLG will be required to return all PI on hand to the Department. HUD Reviewers did not review the status of the state's implementation of this policy. However, during an interview with HCD staff on 29 November 2017, the state indicated that it has not exercised its authority to recapture local program income under its *Program Income Reuse Agreements* when circumstances have called for that response.

Effect: The state's *Program Income (PI) Reuse Agreement* is administratively burdensome for the state, is not properly implemented, and potentially slows the expenditure of program income funds by UGLGs.

Recommended Action: The state's should consider making adjustments to its *Program Income (PI) Reuse Agreement* to lessen the administrative burden for itself and for its UGLG's, making

it simpler to implement and possibly increasing its expenditure of program income funds by its UGLGs.

SCOPE OF REVIEW – NSP1

This section of the report summarizes the areas and program requirements reviewed. The table below depicts a financial summary of the state’s NSP1 grant as of November 27, 2017 as reported in the Disaster Recovery Grant Reporting (DRGR) system. Moreover, the state has approximately \$7,000,000 in program income on-hand that has not been reported in DRGR. All NSP1 grant funds must be fully expended and all activities completed before the state can closeout its NSP1 grant program.

NSP1 Grant Amount	\$145,071,506	Program Income Received	\$44,668,163
NSP1 Grant Funds Disbursed	\$141,667,693	Program Income Disbursed	\$44,668,163
NSP1 Grant Funds Remaining	\$ 3,403,813	Program Income Remaining	\$ 0.00

The scope of the NSP1 review included homeownership projects administered by the cities of Roseville, Vacaville, and West Sacramento (NSP1 recipients), concentrating on eligible use A: Financing Mechanisms. Roseville and Vacaville only provided direct homebuyer assistance, whereas West Sacramento utilized a developer (Mercy Housing) to acquire, rehabilitate, provide direct homebuyer assistance, and resell single family homes to NSP1 eligible homebuyers. Roseville has completed all its activities, expended all awarded funds, and the state executed a closeout agreement in July 2017. Both West Sacramento and Vacaville have activities still underway.

A total of 19 homebuyer files were reviewed. Eight (8) of those files were from Roseville which was 100 percent of the homebuyers it served. The other 11 files (out of its 24 files) were from Vacaville. The state did not have any homebuyer files from West Sacramento and these files could not be made available for monitoring.

Area Reviewed and Results

NSP1 Eligible Use A: Financing Mechanism

NSP1 was authorized in the Housing and Economic Recovery Act of 2008 (HERA) with associated program requirements in Federal Register Notice October 19, 2010 (FR-5447-N-01). Under eligible use A, a grantee may establish financing mechanisms for purchase and redevelopment of foreclosed upon homes and residential properties, including such mechanisms as soft-seconds, loan loss reserves, and shared-equity loans for low- and moderate-income homebuyers.

The funding for the three state NSP1 recipients is as follows:

	Budgeted	Obligated	Disbursed
Roseville	\$ 552,319	\$ 552,319	\$ 552,319
Vacaville	\$2,926,111	\$2,926,111	\$ 852,985
West Sacramento	\$2,412,803	\$2,412,803	\$ 991,474

The monitoring exhibits used are:

- 3-4 National Objectives LMH
- 3-3 National Objectives LMC
- 3-22 Homeownership
- 8-10 NSP1 Program Progress
- 8-11 NSP National Objectives
- 8-13 NSP States
- 8-14 NSP Affordability
- 8-16 FHEO

In addition, interviews were conducted with personnel from the state Department of Housing and Community Development and city of West Sacramento regarding the procedures used to implement and manage the NSP1 activities. From the state of California, Karen Patterson, Compliance and Closeout Manager, and Andrea Anderson, Representative II, were interviewed. Also interviewed was Raul Huerta from the city of West Sacramento.

Based on this monitoring review, HUD has identified ten (10) findings and two (2) concerns with regard to the NSP 1 program. Technical assistance with respect to the Disaster Recovery Grant Reporting (DRGR) system was provided. Further, more intensive technical assistance for the state’s NSP1 and 3 grants will be provided in the near future.

Area Tested: Acquisition Discount

Finding 1: Grantee did not ensure that all properties were purchased with the required minimum discount.

Condition: Both the cities of Roseville and Vacaville used NSP funds to establish financing mechanisms. The cities allowed homebuyers to work with a Realtor to find a foreclosed upon home in its identified NSP1 areas of greatest need. The City provided direct homebuyer assistance in the form of a soft-second loan for down payment and closing cost assistance up to \$120,000. The loan is not due and payable until the home is sold, and the city would receive a pro rata share of the home’s equity at the time of sale or at the end of the 45-year term of the loan. The homebuyers were required to negotiate a sales price with a 1 percent discount. A review of 11 out of 24 homebuyers for the city of Vacaville revealed that 2 homes (230 Troon and 349 Havasu) were purchased with less than 1% discount or with no discount.

Criteria: NSP1 requires a grantee to ensure that all foreclosed upon homes are initially purchased with at least a 1 percent discount. “Each foreclosed-upon home or residential property shall be purchased at a discount of at least one percent from the current market-appraised value

of the home or property.” (75 Fed. Reg. 64338, II.Q.1) Furthermore, “The address, appraised value, purchase offer amount, and discount amount of each property purchase must be documented in the grantee’s program records. The address of each acquired property must be recorded in DRGR. (75 Fed. Reg. 64338, II.Q.3).

Cause: The state does not have an established process to review NSP1 transactions for program compliance in place. It also did not include specific NSP1 requirements in its agreements with NSP1 recipients. From interviews with staff it was clear that state process was to look for compliance issues when they monitored its NSP1 recipients. The monitoring plan was not renewed after 2011 meaning that the state did not follow through on its NSP monitoring responsibilities.

Effect: This has resulted in non-compliance with the 1 percent acquisition discount (75 Fed. Reg. 64338, II.Q.1) and may have impacted the homebuyer financially.

Corrective Action: In conjunction with its NSP1 recipients, the state must review all relevant documentation which may support the properties were purchased at a discount. The state must establish policies and procedures to ensure compliance with the purchase discount requirement. The state should train its NSP1 recipients so that they understand the NSP1 requirement that all foreclosed NSP1 eligible properties are purchased with at least a one percent discount.

Area Tested: Cost Reasonableness

Finding 2: Grantee did not ensure that all costs were reasonable and necessary.

Condition: The city of Roseville’s homebuyer program was designed to provide homebuyer assistance up to \$120,000. From the files reviewed, it appeared that the city typically provided either \$60,000 or \$70,000 in direct homebuyer assistance. The city of Vacaville restricted its assistance to the lesser of \$50,000 or 20 percent of the purchase price. However, the documentation reviewed in both cities’ files was not sufficient to demonstrate that NSP1 funds were used in compliance with all applicable requirements. The state also did not provide evidence to demonstrate that the amount of homebuyer assistance was reasonable and necessary for each homebuyer.

Criteria: The state is required to ensure that NSP funds are used in compliance with program requirements and are only spent for reasonable and necessary costs [24 CFR 570.489(d)(1)(i) and (ii)]. The state is also required to establish and maintain records as may be necessary to facilitate review and audit by HUD [24 CFR 570.490(a)].

Cause: The cities of Roseville and Vacaville did not provide documentation to the state that they performed an underwriting analysis for each homebuyer to ensure that the amount of assistance provided was reasonable and necessary to complete the sale, in that the homebuyer did not receive more or less assistance than they needed.

Effect: This situation may have unduly enriched homebuyers and NSP1 funds may have been utilized to assist more eligible homebuyers under a more stringent review process.

Corrective Action: The state must develop policies and procedures that include an analysis of need when providing direct homebuyer assistance with NSP funds. It should also contact the cities of Roseville and Vacaville for complete homebuyer files to determine if the amount of direct assistance was necessary and reasonable. The state should reimburse its local NSP account in an amount equal to any unreasonable or unnecessary assistance provided to homebuyers by the cities of Roseville and Vacaville.

Area Tested: Tenant’ Protection Documentation

Finding 3: Grantee did not document files to demonstrate that it met the NSP tenant protection requirements under the American Recovery and Reinvestment Act of 2009, Pub. L. 111-5 (Recovery Act).

The Recovery Act imposes requirements on Neighborhood Stabilization Program (NSP) grantees to ensure that bona fide tenants in NSP-assisted properties receive proper treatment.

SUMMARY OF NSP TENANT PROTECTION REQUIREMENTS UNDER THE RECOVERY ACT

PERSONS AFFECTED	Any <i>bona fide</i> tenant occupying certain residential property under a lease in effect on or before the date of notice of foreclosure.	Any <i>bona fide</i> tenant occupying certain residential property without a lease or with a lease terminable at will under state law at the time of foreclosure
IMPLICATIONS	Initial successor in interest (ISII) (see key terms) must allow such tenants to remain to end of the lease term* and provide a minimum 90 days notice to vacate. These periods may overlap but cannot be less than 90 days.	ISII (see key terms) must provide such tenants a minimum 90 days notice to vacate.
EXCEPTION	*An ISII selling the property to a person occupying the home as the primary place of residence MAY terminate the lease, but MUST allow at least 90 days to vacate.	

Source: https://www.hud.gov/sites/documents/DOC_16295.PDF

Condition: The grantee failed to document whether or not the initial successor in interest acknowledged that there were bona-fide tenants occupying the property at the time title was conveyed. This may have resulted in bona fide tenants not receiving the protections afforded to them under the Recovery Act. Grantees need to be aware that the NSP tenant protection requirements under the Recovery Act are separate and apart from the obligations imposed on grantees by the Uniform Relocation Assistance and Real Property Acquisition Act of 1970 (URA). The URA applies to any person displaced as a direct result of acquisition, rehabilitation, and/or demolition of real property for a federally-assisted project.

Criteria: The grantee shall maintain documentation of its efforts to ensure that the initial successor in interest in a foreclosed upon dwelling or residential real property has complied with the requirements under section II.K.2 of 75 FR 64335, the “NSP Unified Notice”. If the grantee determines that the initial successor in interest in such property failed to comply with such

requirements, it may not use NSP funds to finance the acquisition of such property unless it assumes the obligations of the initial successor in interest.

Cause: It is unclear from the record and staff interviews why this documentation is not included. The state did not take an oversight role when homes were sold or monitored after 2011 to ensure compliance with the NSP requirements. The following addresses were reviewed:

Roseville

18 Marty Circle
328 Bettencourt Dr
337 Sawtell Road
831 Shearer Street
1084 Windermere Ave
11802 Dante Circle
208 Emerald Oak
8797 Cortina Circle

Vacaville

100 Andover Way
112 Revere Court
117 Heritage Drive
136 Longview Court
154 Woodridge Circle
178 Glacier Circle
196 Marna Drive
218 Warren Drive
219 Cambridge Drive
230 Troon Court
349 Havasu Drive

Effect: It is unknown if any of the properties sold had bona-fide tenants and relocation benefits may have been due to those tenants.

Corrective Action: The state must provide HUD with an explanation how NSP1 recipients met this requirement and must request the initial successor in interest and tenant's rights protection (ISII – TRP) documentation from the cities of Roseville and Vacaville. Copies of the documentation should be provided to HUD.

Should the state not be able to produce adequate documentation or demonstrate that efforts to ensure that the ISII – TRP requirements were followed when NSP1 was implemented, the state must publish a notice in newspapers of general circulation that includes a list of the 19 addresses reviewed during the monitoring, inviting any tenants who may have resided at one of those addresses before the sale of the home to the NSP1 homebuyer to contact the state. The state must review any claim submitted and determine if any benefits were due to that individual or household. The state must submit copies of the certificates of publication, a list of respondents to the published notice, and any further actions that the state may have or will take to ensure that the rights of the identified tenants, if any, were protected. Further, the state is required to develop

policies and procedures for how the state through its NSP1 recipients will ensure that tenants' rights are protected and that all required notifications will be done. Failure to satisfy this requirement could result in repayment of funds expended on these homes.

Area Tested: Program Income

Finding 4: Grantee did not document NSP program income in the Disaster Recovery Grant Reporting system (DRGR)

Condition: State staff interviews revealed that there is approximately \$7,000,000 of NSP1 program income that has not been receipted in DRGR. This was repeatedly referred to during each day's wrap-up meeting with state staff. NSP program income is to be reported in the quarterly performance report in the quarter in which it was received.

Criteria: The receipt and expenditure of program income as defined in 24 CFR 570.500(a) shall be recorded as part of the financial transaction of the NSP program. 75 Fed. Reg. 64337, II.N.1, II.O.1.b. and 24 CFR 570.490(a).

Cause: It appears that the state has undergone multiple re-organizations and staff has experienced significant turnover. The state is avoiding receipting program income in the Disaster Recovery Grant Reporting (DRGR) system until they have a viable project.

Effect: The state was not receipting NSP program income and therefore could not draw program income before grant funds as required

Corrective Action: The state must receipt all program income in DRGR within 60 days of the date of the monitoring report and regularly quarterly thereafter. It also must develop a written policy and procedure on the receipt of program income in a timely manner. The state shall document that appropriate staff have been trained on the program income policy and procedure.

Area Tested: Monitoring

Finding 5: Grantee does not have a continuing NSP monitoring plan or policy.

Condition: The state staff revealed that the last NSP monitoring took place in 2011 and does not have a continuing monitoring plan or policy. The records reviewed included completed monitoring's of selected NSP1 recipients from 2011 and the resolution of some findings in 2012. Records subsequent to 2012 do not demonstrate the monitoring of subgrants, strategies, or plans.

The state also issued an NSP1 grant closeout agreement to the city of Roseville in July 2017. Upon review of the state files, it was noted that information was missing from the Roseville file regarding initial successor in interest, bona fide tenants, voluntary acquisition, lead-hazard information and, if needed, testing/remediation, and clearance testing. This could have been avoided by monitoring the recipient prior to grant closeout.

Criteria: The state shall make reviews and audits, including on-site reviews, of units of general local government as may be necessary or appropriate to meet the requirement of section 104(e)(2) of Title I; 24 CFR 570.492(a)

Cause: Because NSP activities were mostly completed by the beginning of 2012, the state no longer made it a priority and devoted limited staff oversight resources.

Effect: NSP recipients maintained inadequate documentation for their NSP activities.

Corrective Action: The state should revise its monitoring policy and procedure. This should identify all the documentation needed for a NSP1 homebuyer a file for NSP1 compliance and train staff on what to look for and review of files as needed. Further, the state must establish an on-going annual monitoring plan to ensure NSP1 compliance. This will be essential for the state to close its NSP grants.

Area Tested: Down Payment Assistance

Finding 6: Grantee did not document the amount of down payment assistance provided to each homebuyer.

Condition: The state's recipient files do not include information necessary to determine whether NPS down payment assistance was limited to 50 percent of the down payment. The missing factor is down payment minimums required by lenders. We note that the HUD-1 closing document for each transaction fails to identify these factors.

Criteria: Section 105(a)(24)(D) of the HCDA

Cause: The state did not implement a process to ensure that NSP down payment assistance did not exceed 50 percent of the down payment amount

Effect: The state may have allowed down payment assistance in excess of the 50 percent limitation.

Corrective Action: The state must contact each NSP1 recipient to determine the amount of down for down payment assistance provided using NSP1 funds for all sales of homes to NSP1 eligible households and provide that information to HUD. To the extent that homebuyers received down payment assistance in excess of the 50 percent limitation, the state may be liable for ineligible costs.

Area Tested: Lead-Based Paint

Finding 7: Grantee did not document compliance with the Lead-Based Paint requirements.

Condition: The city of Roseville reported one home built prior to 1978 and Vacaville reported six. None of the files reviewed contained source documentation indicating that: 1) lead-based paint brochures were provided to homebuyers (regardless of the age of the home); 2) lead-based paint testing occurred and, by extension, lacked reports on mitigation or remediation efforts.

Criteria: States shall devise, adopt and carry out procedures with respect to assistance under Title I that fulfill the objectives and requirements of the Lead-Based Paint Poisoning Prevention Act (42 USC 4821-4846), the Residential Lead-Based Pain Hazard Reduction Act of 1992 (42 USC 4851-4856), and implementing regulations at part 35, sub parts A, B, J, K, and R of this title; 24 CFR 570.487(c).

Cause: The state did not follow up with its NSP recipients to ensure compliance with the lead-based paint regulations.

Effect: Some NSP homebuyers may have purchased a home with lead hazards that could have serious health impacts to children under six, seniors, and disabled persons. These persons could develop medical issues due to lead poisoning.

Corrective Action: The state must ensure that its NSP1 recipients contact each homeowner who purchased an NSP home that was built prior to 1978 and implement lead hazard control requirements up to remediation, if needed. The state also must develop appropriate policies and procedures and train its staff and its NSP1 recipients so that lead hazard reduction requirements are met.

Area Tested: Financial Management

Finding 8: There are insufficient internal controls in place to ensure that the NSP funds are being used in compliance with all applicable statutory and regulatory provisions.

Condition: The state allowed its NSP1 recipients to draw funds in advance due to cash flow issues. The state was not keeping files in sufficient detail to ensure that program requirements were met. The state does not require its NSP1 recipients to provide supporting documentation for requests for reimbursement. Again, the assumption was that any issues would be found when the NSP1 recipient would be monitored. However, since the state stopped monitoring in 2011, that assumption was wrong.

A review of homebuyer files and the NSP Standard Agreement revealed that the state is not following HUD requirements or its own agreement conditions in the following ways:

- a. There is no evidence in any of the three city files reviewed of submitted quarterly program income reports that documented program income was used within 90-days of receipt.
[Section 5, B]
- b. The files presented did not include information in sufficient detail to ensure compliance with Section 7 “Milestones” in the standard agreement. Specifically, the agreement states that any funds not expended by September 30, 2011 will be disencumbered by the state.
- c. Advance payments are allowed up to 75 percent of a budget line item (Exhibit B). There was no evidence provided in the advance draw from the city of West Sacramento reviewed in the amount of \$158,787 dated 1/27/2010 that this was done. The recipient must expend the advance funds within 90-days from the date that it received the advance funds and provide

the state with 1) proof of expenditure; refund of all unexpended funds; and 3) return of interest amounts that exceed one hundred dollars per fiscal year.

Criteria: Recordkeeping requirements at 24 CFR 570.490(a)(1) state that, “The State shall establish and maintain such records as may be necessary to facilitate review and audit by HUD of the state’s administration of CDBG funds under §570.493.” According to §570.493(b), “A state’s failure to maintain records in accordance with §570.490 may result in a finding that the State has failed to meet the applicable requirement to which the record pertains.” The state is required to have fiscal controls such that it can ensure the funds are used in “compliance with all applicable statutory and regulatory provisions,” “only spent for reasonable and necessary costs,” and “not used for general expenses required to carry out other responsibilities of and local governments.” §570.489(d).

Cause: The state adopted the practice of not requiring full documentation (supporting documents) from its NSP1 recipients because it intended to monitor the grants at a later date for compliance. Unfortunately, the state has let its monitoring strategy and plan lapse.

Effect: The state authorized advance and reimbursement payments without the required documentation as documented in its own standard agreement. This may result in the identification of ineligible costs paid for with NSP funds.

Corrective Action: The state must obtain the necessary supporting documentation to support NSP1 expenditures and performance reports from each NSP1 recipient. This documentation should be reviewed and analyzed to make sure only eligible costs were paid with NSP1 funds. The state must provide copies of this documentation to HUD. The state should also develop and/or revise its recordkeeping policies and procedures to ensure that supporting documents are reviewed prior to approval of reimbursements to avoid this situation in the future. To the extent that the state cannot properly support questioned costs, the state may be liable for repaying such funds.

Area Tested: Developer Fee and Activity Delivery Costs

Finding 9: Grantee did not properly allocate developer fees and activity delivery costs.

Condition: A review of the agreement between the state and West Sacramento revealed that in Exhibit B there is a line item for General Administration and another one for Activity Delivery costs. The state allowed its NSP recipients to reimburse developers for activity delivery fees and general administration.

An advance of \$158,787 dated 1/27/10 submitted by the city of West Sacramento was reviewed. The funds were to be passed down to the City’s development partner, Mercy Housing. The budget for Mercy Housing has three-line items: General Program Administration, Loans to Non-Profits and Developers, and Activity Delivery – Loans to Non-Profits and Developers. The reimbursement request reviewed was for activity delivery fees (acquisition, rehabilitation, and disposition) which totaled \$16,153 and loans to non-profits and developers. Developers are program beneficiaries and thus distinct from subrecipients, grantee employees, and contractors. Developers may receive NSP funds from either the grantee or a subrecipient and are entitled to a

“developer fee” but not administration or activity delivery costs. If Mercy Housing was treated as a subrecipient it would be eligible for administration and activity delivery costs but not a developer fee. However, HUD notes that some fees billed as activity delivery or general administration could eligibly be part of a developer fee.

Criteria: 24 CFR 570.489 (d) (2) and (d)(2)(i) and (ii)

NSP1 grantees should note that they may but are not required to treat all third-party development entities as subrecipients. HUD regulations treat developers as private entities entitled to benefit under 570.202(b)(1). This is important in situations where a private for-profit or nonprofit organization receiving NSP1 funds is neither a contractor nor a subrecipient. In such instances, the developer is not an intermediary acting for the grantee, but is receiving assistance itself as a beneficiary under the program.

The right to charge a developer’s fee is available only to an entity that receives assistance from the grantee or the subrecipient and assumes some of the risk of the project, which the developer does by investing some of its own money in the project. Grantees and subrecipients are compensated for the actual costs of carrying out eligible activities, which reduces or eliminates any development risk if actual costs exceed estimates. Therefore, accounting principles and cost circulars do not allow grantees or subrecipients to collect a developer’s fee. Please refer to the NSP Policy Alerts on “*Guidance on Developers, Subrecipients, and Contractors* at:

<https://www.hudexchange.info/resource/326/hud-nsp-policy-alert-guidance-on-developers-subrecipients-and-contractors-implications-of-using-different-entity-types-to-carry-out-nspfunded-activities>

and also on *Allocating Real Estate Development Costs* at:

<https://www.hudexchange.info/resource/318/hud-nsp-policy-alert-guidance-on-allocating-real-estate-development-costs-in-the-neighborhood-stabilization-program>

Cause: The state did not require source documentation when processing payment requests. If it had, this finding of non-compliance may have been identified. Further, the state assumed that areas of non-compliance would be identified through on-site monitoring which the state has not conducted since 2011.

Effect: The state allowed payment in the amount of \$16,153 to Mercy Housing for activity delivery fees in error. Mercy Housing should have been receiving a developer fee.

Corrective Action: The state must provide HUD with clarification of how a developer is reimbursed as opposed to a subrecipient or contractor. In addition, the state should conduct a file review to locate supporting documentation that either 1) showed that Mercy Housing has a subrecipient agreement with the city of West Sacramento; or 2) Mercy Housing has a developer agreement with the City. The should determine if the payment of the activity delivery fees were eligible, reasonable, and necessary. Copies of the analysis and agreement(s) should be provided to HUD.

If the state cannot find supporting documentation and/or determines that Mercy Housing was treated as a developer, the state must reimburse NSP1 in an amount of \$16,163 which was the

activity delivery costs contained in the advance payment request reviewed for contract 09-NSP1-6150.

Further, the state should develop appropriate policies and procedures that deal with ensuring costs are eligible in the budget as well as for each request for payment processed. The state should train its staff and any appropriate staff from its NSP1 recipients.

Area Tested: Affordability Period

Finding 10: The grantee failed to include the affordability period as a restrictive covenant running with the land in each recorded deed of trust for NSP1 properties.

Condition: The NOFA applications from Roseville, Vacaville, and West Sacramento indicated that they would adopt the HOME affordability periods. The applications were incorporated into each NSP1 recipient agreement by reference. However, the recorded Deeds of Trust and Promissory Notes include the shared equity loans but do not contain language about affordability periods.

Criteria: The NSP Unified Notice at 75 Fed. Reg. 64323, II.B.3 requires that grantees shall ensure, to the maximum extent practicable and for the longest feasible term, that the sale, rental, or redevelopment of abandoned and foreclosed-upon homes and residential properties under this section remain affordable to individuals or families whose incomes do not exceed 120 percent of area median income or, for units originally assisted with funds under the requirements of section 2301(f)(3)(A)(ii) of HERA, as amended, remain affordable to individuals and families whose incomes do not exceed 50 percent of area median income.

Cause: Each NSP1 grantee was able to define its own program parameters in its initial program application and action plan. For affordability period compliance, the state chose the standards established in the HOME Investment Partnerships Program (HOME). However, the affordability period was not outlined in each recorded deed of trust as home sales closed escrow. This left the state in a vulnerable position with the possibility of not being able to enforce the affordability compliance period. It is unclear as to why the state did not include affordability periods running with the land in its recorded Deeds of Trust.

Effect: Based on how the Deeds of Trust are worded it may be difficult for the state to enforce any affordability period. This could result in the state losing needed affordable housing units much earlier than if the affordability periods were adequately documented in its recorded deeds of trust.

Corrective Action: The state may provide additional information and documentation supporting that the affordability periods were incorporated into legally binding documents and that the homebuyer is fully aware of this requirement. If the state cannot provide such documentation, it must ensure that NSP1 recipient revises or adds an addendum to the recorded Deeds of Trust for each property in the NSP1 program. These restrictive covenants should run with the land.

Further, the state should review its policy for NSP1 affordability periods, make revisions as needed, and ensure that there is adequate language in all recorded Deeds of Trust to ensure that

the NSP1 properties will remain affordable throughout the complete affordability period. Then the state must train its staff and any NSP1 recipients still operating an NSP1 program. Should the state be unable to provide this documentation, HUD may require it to reimburse the program for the cost of these loans from non-federal funds.

Concern(s)

Concern 1: Fiscal Controls and Accounting Procedures - Program Income

Condition: Section 5 of the state's standard agreement used for all NSP recipients' states that the recipient may retain earned program income but must use it within the next quarter or return it to the state. This contradicted by the state's Program Income Reuse Plan. The Program Income Reuse Plan states that the NSP recipient may retain earned program income if received before July 30, 2013 and use it on eligible NSP activities. After that date the program income must be returned to the state. The state was unable to provide any evidence that either requirement was enforced.

Cause: It appears that different units within the state's Housing and Community Development Department developed these policies, resulting in conflicting contract and performance requirements in relationship to program income. The problem may have been occasioned by the change in NSP legislation that originally required all program income to be returned to the Treasury by July 30, 2013.

Effect: There are contradicting requirements regarding retaining and using NSP1 program income. The NSP1 recipient is allowed to retain earned program income but it must be expended within the next quarter and reported to the state. The NSP Program Income Reuse Plan allows NSP1 recipients to retain earned program income but after June 30, 2013, any unused program income must be remitted to the state.

Corrective Action: The state should review its standard agreement and Program Income Reuse Plan to revise the program income sections appropriately so that the requirements either complement each other or reconcile. It should also develop written policies and procedures which clearly delineate each division's responsibilities and have written checks and balances. In this way, all staff working on NSP1 will have a clear understanding of the program and each division's roles and responsibilities, and how management will review policies, agreements, and program materials for consistency with program parameters.

Concern 2: Separation of Grant Awards

Condition: The state has developed many forms which are considered complete when information is submitted by its NSP recipients. However, the forms include "NSP1" and "NSP3" in the title with no differentiation between the two funding sources in the form itself.

Criteria: 24 CFR 570.489(d)(1) and 24 CFR 570.490(a)

Cause: The state is not following its own procedures when developing forms to identify funding source used on the forms it developed for NSP.

Effect: Documents are not clear as to funding source and that, in turn, makes it difficult to track expenses and performance measures back to the appropriate funding source.

Corrective Action: The state must review its policies and procedures for grant management to ensure that each grant award is tracked separately from all other funding sources. Appropriate forms should be revised to clearly distinguish funding sources. This will allow the state to report on financial matters and performance by grant award. All appropriate state staff should be trained on the policies and procedures developed as well as any NSP1 recipient.

The Treatment of Pre-existing Corollary Monitoring Findings

HUD agrees to incorporate similar outstanding findings into this monitoring report, and authorizes the simultaneous closeout of similar findings to assist HCD with the administrative burden of having to take corrective actions on this monitoring report and also for older outstanding monitoring findings, and to aid in reconciling current and older findings. The HUD field office will be responsible for providing this closeout matrix to the state, as an Exhibit Addendum to this issued monitoring report.