

OIG Evaluation of Auditee Comments

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

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

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

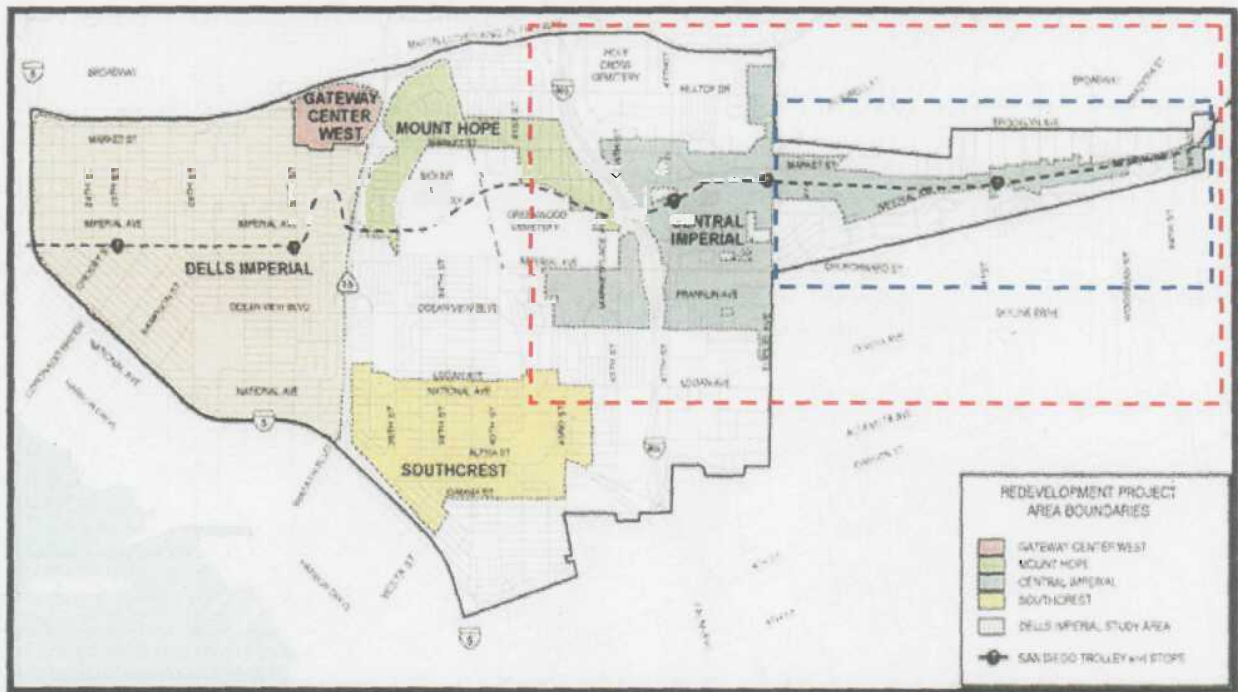
Due to the lack of City controls, the Redevelopment Agency was able to use the CDBG funds as a spending account to pay various unsupported costs with no clear indication the activity was for the CBDG program. 24 CFR 570 has specific rules in place to prevent CDBG from becoming a spending account. Agreements,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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

- Comment 12** The City characterized our recommendation as "forcing repayment." Our recommendation is for the City to create loan agreements with specific terms, and on page 8 of the City's response, it agrees to create loan agreements between the City and the Agency indicating specific loan terms. We agree that the loan terms may vary based on the specific redevelopment project area and tax increment revenue. No evidence has been provided to show a repayment schedule will harm the revitalization effort, and if done properly and according to CDBG rules and regulations, it will ensure a constant flow of funds to continue to develop low- and moderate-income communities and to eliminate blight through the reuse of program income.
- Comment 13** No documentation or analysis has been submitted to show that only 1.04 percent of the tax increment received was attributable to CDBG debt.
- Comment 14** Leveraging is not listed as a **CDBG-eligible** activity under 24 CFR 570. The City's action of disregarding HUD rules and regulations, and general lack of repayment on outstanding CDBG loans, resulted in our description of the City's CDBG loan process as a leveraging tool.