

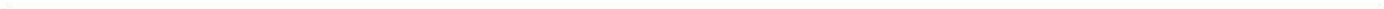


# Office of Community Planning and Development, Washington, DC

## HUD's Oversight of the Use of Community Development Block Grant Funds To Repay Section 108 Loans

**Office of Audit, Region 4  
Atlanta, GA**

**Audit Report Number: 2018-AT-0001  
September 26, 2018**





**To:** Stanley Gimont, Deputy Assistant Secretary for Grant Programs, DG

**//Signed//**

**From:** Nikita Irons, Regional Inspector General for Audit, 4AGA

**Subject:** HUD's Oversight of the Use of Community Development Block Grant (CDBG) Funds To Repay Section 108 Loans Was Adequate

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of HUD's oversight of CDBG funds used for Section 108 repayments.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG website. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 404-331-3369.



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**HUD's Oversight of the Use of Community Development Block Grant Funds  
To Repay Section 108 Loans Was Adequate**

## Highlights

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### What We Audited and Why

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We audited the U.S. Department of Housing and Urban Development's (HUD) oversight of Community Development Block Grant (CDBG) funds used for Section 108 repayments. This audit was part of our annual audit plan. The objective of this audit was to determine whether HUD effectively monitored the use of CDBG funds in repaying Section 108 loans and whether it was feasible to enact a threshold or maximum amount of CDBG funds that grantees may use to repay loans.

### What We Found

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HUD's oversight of the use of CDBG allocations to repay Section 108 loans was adequate. In addition, HUD's information system tracked the extent to which communities and States used CDBG allocations to repay Section 108 loans. Our review of the six recipients that had used their CDBG allocations to repay Section 108 loans did not identify any adverse effect, which would justify establishing thresholds to limit the amount of program funds that may be used to repay loans.

### What We Recommend

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There are no recommendations.

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# Background and Objective

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The Community Development Block Grant (CDBG) program provides annual grants on a formula basis to entitled cities, urban counties, and States to develop viable urban communities by providing decent housing and a suitable living environment and by expanding economic opportunities, principally for low- and moderate-income persons. Over a 1-, 2-, or 3-year period, as selected by the grantee, not less than 70 percent of CDBG funds must be used for activities that benefit low- and moderate-income persons. In addition, each activity must meet one of the following national objectives for the program: benefit low- and moderate-income persons, prevent or eliminate slums or blight, or address community development needs having a particular urgency because existing conditions pose a serious and immediate threat to the health or welfare of the community for which other funding is not available.

Grantees are allowed to use CDBG funds to repay Section 108 loans. The Section 108 Loan Guarantees program is the loan guarantee provision of the CDBG program. Section 108 loans provide grantees with a source of financing for economic development, housing rehabilitation, public facilities, and large-scale physical development projects. The principal security for the loan guarantees is a pledge by the grantee or the State regarding its use of current and future CDBG funds. Section 108 obligations are financed through underwritten public offerings and may be for terms of up to 20 years. An entitlement public entity may apply for up to five times the latest approved CDBG amount.

The audit objective was to determine whether HUD effectively monitored the use of CDBG funds to repay Section 108 loans and whether it was feasible to enact a threshold or maximum amount of CDBG funds that grantees may use to repay loans.

# Results of Audit

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## **Finding 1: HUD's Oversight of the Use of Community Development Block Grant Funds To Repay Section 108 Loans Was Adequate**

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HUD's oversight of the use of Community Development Block Grant (CDBG) allocations to repay Section 108 loans was adequate. In addition, HUD's information system tracked the extent to which communities and States used CDBG allocations to repay Section 108 loans. Our review of six recipients<sup>1</sup> that had used their CDBG allocations for Section 108 loan repayments did not identify any adverse effect, which would justify establishing thresholds to limit the amount of program funds that may be used to repay loans.

### **HUD's Oversight Was Adequate**

HUD's oversight of the Section 108 loan repayments was adequate. The Financial Management Division, within the Office of Community Planning and Development, is responsible for the oversight of Section 108 loan repayments. During the underwriting of the Section 108 loans, HUD analyzed loan repayment amounts against the recipient's CDBG allocation to ensure that the loan did not constitute a burden to the grantee and increase HUD's risk of a loan default. HUD officials informed us that at the time of each quarterly Section 108 loan repayment, HUD verified whether a grantee's CDBG allocation was sufficient to cover the loan repayment amount. In addition, HUD officials stated there had not been a situation in which the CDBG allocation was not sufficient to cover the Section 108 loan debt.

In addition, HUD's Integrated Disbursement and Information System<sup>2</sup> tracked the extent to which communities and States used CDBG allocations to repay Section 108 loans. Grantees assigned specific matrix codes in HUD's information system to Section 108 loan repayments funded with CDBG funds. The data were collected in HUD's information system and made part of national expenditure reports of CDBG-funded activities. However, HUD did not use these data to identify possible trends or changes that could affect the CDBG program.

According to HUD's information system, there had been about a 9 percent decline in the number of recipients using CDBG allocations to repay Section 108 loans. From 217 recipients in program year<sup>3</sup> 2013, the number had declined to 197 during program year 2015 as shown in table 1.

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<sup>1</sup> See the Scope and Methodology section of this report for details on how the recipients were selected.

<sup>2</sup> HUD's Integrated Disbursement and Information System is the drawdown and reporting system for the Block Grant program and includes information regarding activities across the Nation, including funding and accomplishment data. HUD uses this information to report to Congress and to monitor grantees.

<sup>3</sup> Program year pertains to the fiscal period (12-month period) of each Block Grant recipient that captures all of the financial transactions during that period.

**Table 1: Number of recipients using program funds to repay loans**

Program year	CDBG recipients	Recipients using program funds to repay Section 108 loans	Percentage
2013	1,205	217	18
2014	1,207	209	17
2015	1,218	197	16

HUD’s information system also showed that during the 3-year period (program years 2013 through 2015), 1,224 recipients spent more than \$9.9 billion of their CDBG allocations. Of the 1,224 recipients, 231 (19 percent) used more than \$337 million (about 3.3 percent) for Section 108 loan repayments.

The recipients’ loan repayment expenditures showed a decline between program years 2013 and 2015 as shown in chart 1.

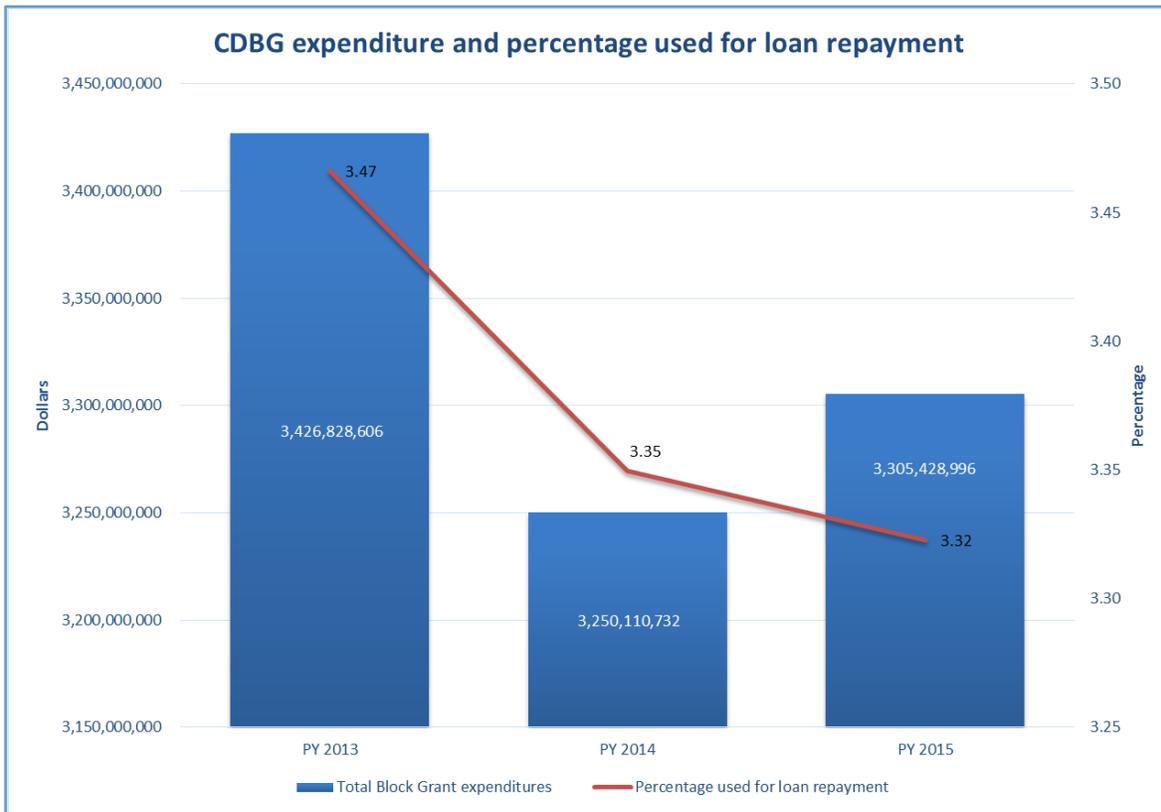


Chart 1: The chart above shows that the percentage of their CDBG allocation that recipients used for Section 108 loan repayments had declined from 3.47 percent (2013) to 3.32 percent (2015) when compared with total program expenditures for the same periods.

HUD’s system also showed a decline in the amount of CDBG funds that recipients used for Section 108 loan repayments as shown in chart 2.

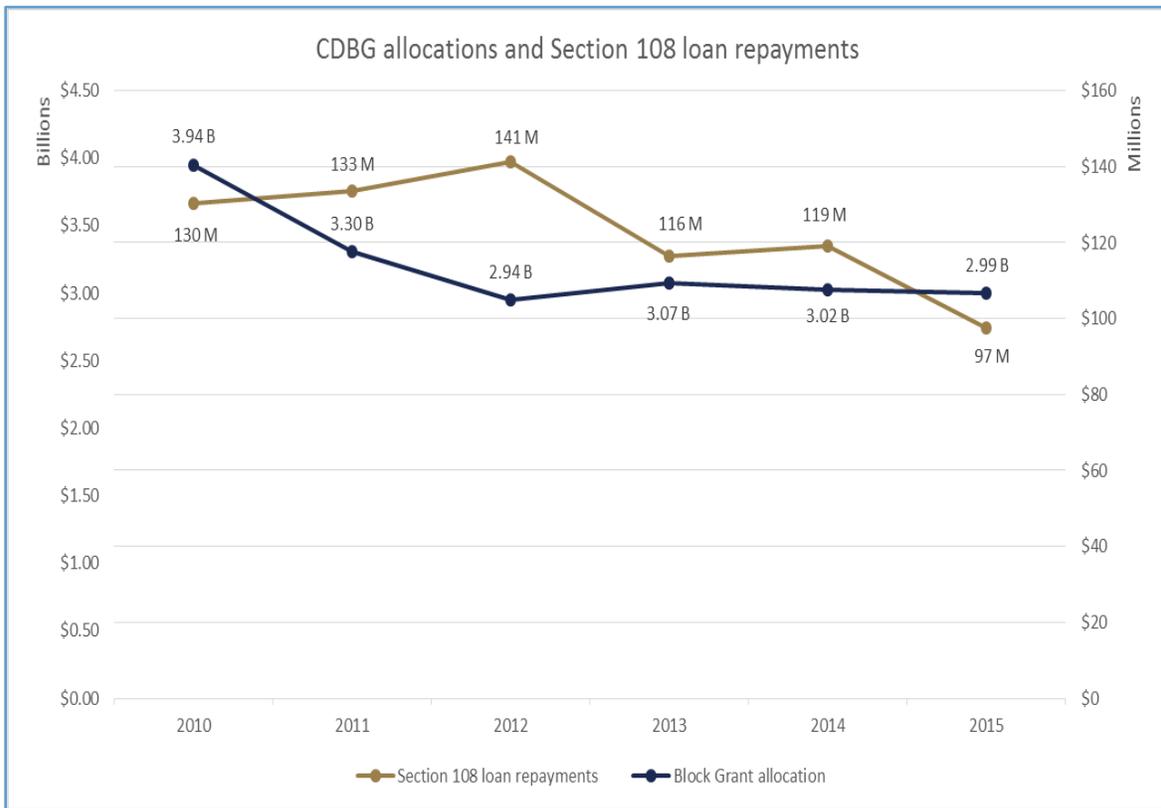


Chart 2: The chart above shows that the amount of CDBG funds that recipients used for Section 108 loan repayments had decreased from \$130 million in 2010 to \$97 million in 2015.

### Enacting a Threshold Was Not Necessary

HUD regulations at 24 CFR (Code of Federal Regulations) 570.705(c) allow the use of CDBG funds to repay Section 108 loans. However, applicable regulations do not establish a limit on the amount of CDBG funds that may be used for Section 108 repayments. HUD officials informed us that grantees may determine the amount of CDBG funds they will allocate for Section 108 loan repayments. Grantees may use their full CDBG allocation for Section 108 if they wish. In addition, HUD does not have a basis to conclude that the amount of CDBG funds allocated for Section 108 loan repayment is too high for any particular grantee.

Of the 231 grantees with Section 108 loan payments, 34 spent more than 50 percent of their CDBG funds on Section 108 loan repayments. Starting in program year 2014, HUD’s information system showed that there had been a 12 percent decline in the number of grantees using more than 50 percent of their CDBG funds for repayment of Section 108 loans (from 34 to 30) as shown in chart 3.

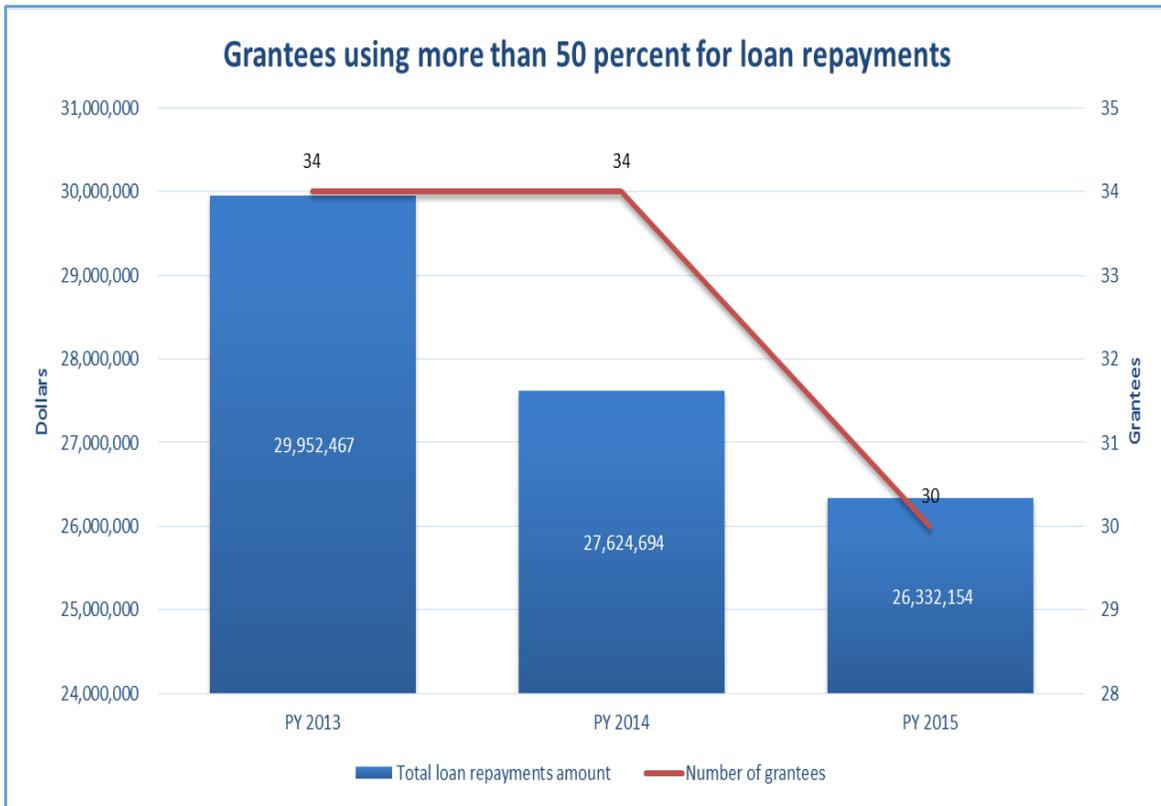


Chart 3: The chart above shows that the number of grantees and the amount of CDBG funds used to repay Section 108 loans declined between program year 2013 and 2015.

We reviewed six grantees that in a 3-year period (program years 2013 through 2015) spent on average more than 75 percent of their CDBG funds for Section 108 loan repayments as shown in table 2.

**Table 2: Recipients that used more than 75 percent of their program funds to repay loans**

Grantee	Program year			3-year percentage average
	2013	2014	2015	
Bayamon, PR	\$2,683,168	\$2,762,205	\$2,375,530	94
Winchester, VA	303,139	202,598	202,914	90
Monterey Park, CA	551,140	670,092	393,731	86
Guaynabo, PR	1,042,105	987,222	212,522	79
Montebello, CA	538,575	535,647	534,975	79
Lenoir, NC	115,854	116,540	116,901	78
<b>Totals</b>	<b>5,233,981</b>	<b>5,274,304</b>	<b>3,836,573</b>	

There were various reasons why each grantee assigned a significant portion of its CDBG funds to repay the loans. For example, one grantee determined that repayment of the Section 108 loan was a priority and decided to repay the 10-year term loan in 5 years. Another grantee took a 10-

year loan instead of the 20-year maximum period. As a result, the above-mentioned grantee used more than 75 percent of its CDBG funds to repay the loan. However, the amount each grantee allocated to repay Section 108 loans was allowable and in accordance with HUD regulations at 24 CFR 570.705(c).

Although the above-mentioned recipients used a significant portion of their CDBG allocations for Section 108 loan repayments, our review did not identify any adverse effect on the grantees' delivery or execution of the program, which would justify establishing thresholds on the use of program funds to repay Section 108 loans. The grantees pledged and used their future CDBG allocation to undertake large-scale projects for the benefit of low- and moderate-income people.

### **Conclusion**

HUD's oversight of the use of CDBG allocations to repay Section 108 loans was adequate. In addition, HUD's information system tracked the extent to which communities and States used CDBG allocations to repay Section 108 loans. Our review of the six recipients that spent more than 75 percent of their CDBG funds for Section 108 loan repayments did not identify any adverse effect on the program and its objectives.

### **Recommendations**

There are no recommendations.

# Scope and Methodology

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We conducted our audit field work from August 3, 2017, through July 31, 2018, at HUD's offices located in Washington, DC, and our offices located in San Juan, PR. The audit covered the period January 1, 2013, through September 30, 2016.

To accomplish our objective, we

- Reviewed HUD's regulations at 24 CFR Part 570 and HUD Handbook 6509.2, REV-7.
- Analyzed CDBG drawdown reports for the period January 1, 2013, through September 30, 2016.<sup>4</sup>
- Examined consolidated annual performance and evaluation reports for program years 2013 through 2015.
- Interviewed HUD headquarters and field office officials.

HUD's information system showed that between January 1, 2013, and September 30, 2016, 231 recipients spent more than \$337 million of their CDBG allocations to repay Section 108 loans. We selected for review the grantees that had used on average more than 75 percent (3-year percentage average) of their CDBG allocations to repay loans. As a result, we selected six grantees with Section 108 loan repayments totaling more than \$14 million. The grantees were reviewed to determine the reasons for their high debt service expenditure and whether it affected the grantees' delivery of the CDBG program and its objectives. We did not select 100 percent of the universe because it was not feasible to review all 231 CDBG recipients due to time limitations and because we were interested in grantees that used a significant amount of their CDBG allocation for Section 108 loan repayments. The results of the audit apply only to items selected for review and cannot be projected to the universe or population.

To achieve our audit objective, we relied in part on computer-processed data from HUD's information system to determine which grantees had Section 108 repayments and the percentage of Section 108 repayments compared to total CDBG expenditures. Although we did not perform a detailed assessment of the reliability of the data, we performed a minimal level of testing and found the data to be adequate for our purposes.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

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<sup>4</sup> The data file used for this review was provided by HUD's Office of Community Planning and Development through the HUD Office of Inspector General's (OIG) Field Analytic Support Division in August 2017. The last full program year available for review was 2015 (period ending September 30, 2016).

# Internal Controls

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Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- effectiveness and efficiency of operations,
- reliability of financial reporting, and
- compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

## **Relevant Internal Controls**

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

- Federal regulations that contain the rules for grantees in carrying out the CDBG program.
- Additional HUD policies and guidance for CDBG recipients.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

We evaluated the internal controls related to the audit objective in accordance with generally accepted government auditing standards. Our evaluation of internal controls was not designed to provide assurance regarding the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of HUD's internal control.

# Appendix

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## Appendix A

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### Auditee Comments and OIG's Evaluation

HUD did not provide any comments to the report.