

**CHAPTER 7**

**FOLLOW-UP PROCEDURES**

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## **CHAPTER 7**

### **FOLLOW-UP PROCEDURES**

*Case #1: The Community Development Director of Gotham City and her staff took their subrecipient monitoring responsibilities seriously. Unfortunately, the care they put into crafting thorough and individualized monitoring letters meant that the letters often did not reach subrecipients until three to four months after the site visits had taken place. In addition, an intensive monitoring schedule left very limited time for contacting subrecipients between monitoring visits. Given the emphasis they put on monitoring, the CD staff were discouraged by the large number of “repeat findings” they uncovered during subsequent reviews of subrecipients’ activities.*

*Case #2: In the City of Port Culis, staff of the CD office rarely performed “formal” monitoring of their experienced subrecipients, particularly formal comprehensive monitoring. The CD Director assumed that these subrecipients knew the regulations and their responsibilities and would resent the “nitpicking” of formal monitoring. However, when a HUD Field Office review compelled the CD Office to monitor their subrecipients formally, site visits revealed serious deficiencies in the record-keeping, administrative systems, and program compliance of many experienced subrecipients, even among organizations the CD Director had regarded as exemplary.*

*Case #3: The CD Director of Parva preferred to emphasize frequent technical assistance visits to subrecipients rather than formal monitoring. He felt that formal monitoring would only make subrecipients feel defensive and would put a strain on the pleasant working relationship the CD office had struggled to establish with them. About nine months into the program year, however, he became frustrated with the subrecipients’ failure to implement the recommendations he offered in the technical assistance visits. As a result, he concluded that stronger action was necessary. He instructed the CD monitoring staff to conduct formal subrecipient monitoring reviews “by the book” for the rest of the program year. Not surprisingly, the initial reviews resulted in scores of findings, questioned costs, and disallowances. Within a few days of the monitoring visits, the Parva CD Director realized that he had opened a political Pandora’s box. Groups of subrecipients were contacting city councilors and the mayor’s office to complain bitterly that the CD Office had “changed the rules” and had “set them up.” The CD Director was ordered to appear before the city council to explain his action.*

#### **INTRODUCTION**

The hypothetical scenarios above describe three different approaches to subrecipient monitoring, all of which failed to promote better performance. *Although well-intentioned, all three approaches fall short because of inconsistent or inadequate follow-up.* This chapter discusses techniques you can use to follow up on subrecipient monitoring to make sure that subrecipients correct the problems you brought to their attention as a result of the monitoring. While found, you must still ensure that subrecipients realize they will be sanctioned for problems they fail to remedy and rewarded for good performance. Some common problem areas of subrecipient monitoring are discussed in the Appendix to this chapter.

**BASIC FOLLOW-UP  
PRINCIPLES**

The approaches used in the cases just described fail to adhere to one or more of the four principles of effective follow-up:

□ **Accountability**

1. ***Make sure your subrecipients know that they are accountable for their performance (as defined by the Agreement) and for observing all program rules.*** Accountability means that there are understood consequences for observing and not observing program rules and regulations, and that satisfactory performance is a requirement for the reimbursement of costs and continued participation in the CDBG program. Accountability means that:

*Accountability means follow-up and follow-through.*

- you will *follow up* to verify that the subrecipient implements the corrective actions called for in your monitoring letter, and
- you will *follow through* to impose sanctions if effective action has not been taken.

□ **Clarity and Consistency**

2. ***Make sure the standards for satisfactory performance, and the sanctions and rewards for performance are clear and consistent.*** Communicate ahead of time your definition of satisfactory performance, including keeping adequate records and assuring that services specified in the written Agreement are delivered on time and within the budget. Don't change your standards of acceptable performance after the fact.

□ **Regular Feedback**

3. ***Based on your monitoring, let your subrecipients know how they are doing on a regular and complete basis.*** Don't provide feedback just once a year in a monitoring letter, but rather every time you have a chance to observe subrecipient activities. Don't catch your subrecipients by surprise with your criticisms.

□ **Timeliness**

4. ***Make all your communications with subrecipients, especially those regarding the results of your monitoring visits, timely.*** Let your subrecipients know right away when there are problems. The longer you wait, the worse the problems will get and the more difficult it will be to solve them.

*“If the monitoring results were so darned important, why did it take four months to tell me about them?”*

*-Disgruntled subrecipient*

*“You have to be willing to use a big stick. If there are no consequences, they won’t pay attention.”*

*-CD Program Specialist*

In the first example above (Gotham City), instead of letting the subrecipients know quickly what issues they needed to address and how, the CD staff spent too much time worrying about the details of the problems their monitoring revealed and too little time telling their subrecipients the monitoring results. When the link between monitoring and follow-up is not direct and immediate, you will be issuing findings long after the visit. As a result, your subrecipients may ignore them, because they feel the findings don't apply to their current activities.

In the second case (Port Culis), the real hang-ups are lack of accountability and feedback. Without monitoring and follow-up, there can be no accountability. Even the best performers may not keep doing good work or continue to comply with program rules without your regular attention and support. Without regular monitoring and follow-up, subrecipients may get the feeling that no matter what they do, good or bad, they are entitled to the same (or higher) level of support year after year.

In the third case (Parva), the central weaknesses of the CD Director's monitoring are lack of clarity and consistency. *Subrecipients have a legitimate expectation that the “rules of the game” are not going to change without warning [or as a result of arbitrary decisions by a CD Director].* Your definitions of acceptable and unacceptable performance, described in detail and in writing before the award, need to be invariable and unambiguous. Simply “getting tough” after you discover unacceptable performance is likely to make subrecipients stubborn about fixing problems, especially if they feel you have changed your definition of “acceptable” performance or you have cracked down on a problem you never told the subrecipients they were responsible for handling.

**FOLLOW-UP IN A  
CHANGING REGULATORY  
ENVIRONMENT**

Despite the need for consistency in your performance requirements, everyone knows that certain CDBG regulations, or their interpretation, do change. For example, with regard to economic development activities, the changes in the legislative language from “necessary or appropriate” to “appropriate” alone, followed by the imposition of specific public benefit requirements, as well as HUD’s interpretation of the language, resulted in some confusion. In some circumstances, you may want to take a *conservative approach* with your subrecipients and rely on a “narrow” interpretation of the rules.

**THE INFLUENCE OF  
POLITICS**

Say, for instance, that in the absence of any other funding source, one of your local development corporations would like to provide a struggling business with a \$30,000-economic development “survival” loan that will keep jobs. However, the business can produce no financial records or pro formas that allow you to gauge the “feasibility” of the project or assess the likelihood of its success.

If you provide the loan, you and your subrecipient may be asking for trouble. The business might not survive and that would raise questions about how a CDBG National Objective was met. It is probably better to wait until the documentation needed for assessing risk and underwriting the loan is available. On the one hand, such delays may preclude providing support to some worthwhile projects; on the other hand, caution may save you from costly confrontations with HUD later.

Most grantees acknowledge that their selection of subrecipients can sometimes be influenced by political considerations. These political considerations can take the teeth out of your monitoring and follow-up systems, because a subrecipient may think it is “immune” to findings, disallowances, or other sanctions because of its political connections.

You can take four steps that will help you conduct effective follow-up with these “well connected” subrecipients:

- ❑ ***Try to establish standard selection criteria that will help ensure that an entity applying to be a subrecipient must demonstrate that it has appropriate qualifications for undertaking CDBG activities.*** Even if the final choice of subrecipients is not yours, the careful assessment of qualifications will help you to anticipate the types of problems you are likely to face with such organizations as subrecipients, and to prepare you to deal with them.
- ❑ ***Insist on clearly defined and measurable performance expectations in a written Agreement.*** This will enable you to document poor performance or noncompliance, and to use the evidence to counter a subrecipient's claims that it was unaware of the grantee's expectations, or the subrecipient's refusal to respond to findings and concerns.
- ❑ ***Share your dilemma with key elected officials (mayor, city council).*** If your informal, pre-monitoring visits suggest that you will find serious deficiencies during the monitoring visit, sharing the circumstances and the documentation with appropriate elected officials can help motivate the subrecipient to take action before its problems become part of the public record.

*It also helps to get politicians to “buy into” a performance standards approach before subrecipients are involved.*

*If a subrecipient looks bad, the grantee looks bad too.*

- **Point out the risks.** It is fair to point out to both elected officials and to subrecipients that HUD can impose sanctions on your entire program for substantial or continued subrecipient noncompliance with HUD rules. Most administrative and elected officials are unwilling to assume the risk of compromising the entire CDBG program and will therefore agree to pressure the subrecipient to rectify the operational deficiencies you have identified.

If a media story or outside review focuses attention on poor subrecipient performance that you have tolerated, your agency's reputation will probably be tarnished just as much as the subrecipient's, no matter what political support you or the subrecipient may have enjoyed previously. If a subrecipient looks bad, you look bad.

If the subrecipient looks good, you and the elected officials can share in the credit. Try to convince local officials that good subrecipient performance is good for politics. For example, competent subcontractor performance helps protect them from charges of political favoritism.

**REWARDING SUPERIOR OR IMPROVED PERFORMANCE**

*Grantees should use “rewards or recognition for outstanding performance” as a technique to encourage improvement among their subrecipients.*

Securing official support for following up on monitoring results can be a lot easier if you can get subrecipients *to meet performance expectations through positive motivation*, rather than through imposing sanctions. Relying on penalties alone can result in a contentious relationship with your subrecipients. As a result, you may overlook (and therefore not reward) examples of superior performance. It helps to appreciate what has been accomplished already. It also helps to acknowledge a subrecipient's efforts at improvement, even when there's still a long way to go.

There are a variety of ways to reward good performance and regulatory compliance among your subrecipients.

- **Praise for Performance**

In your monitoring letters and other communication with subrecipients, **pay as much attention to areas of success as to areas that need work**. For example, if a community development corporation has recently completed a 20-unit rehabilitation project, but has neglected to complete inspections of the last three units, recognition of the primary achievement should precede your concern for the missing inspections.

There are few things more discouraging than to have your achievements taken for granted while your flaws are publicly scrutinized and censured. Consider issuing special letters of commendation or even organizing annual awards ceremonies for the best performers in various categories of activities. Send copies of the letter to pertinent public officials and invite these officials to your

award ceremonies. (Be aware when holding awards events that CDBG funds cannot be used for entertainment.)

□ **Competition**

*Try to create a little healthy competition among your subrecipients.* For example, a simple newsletter might highlight the achievements of particular subrecipients or present information about the (relative) performance of each subrecipient. By also reporting on recent regulatory issues, training opportunities, and application deadlines, the newsletter can take the place of memoranda that a grantee would otherwise have to write and disseminate anyway.

□ **Public Relations**

If you have a good relationship with a local newspaper, radio station, or cable or TV station, *ask it to do a feature story on subrecipient activities that deserve public recognition.* You might also arrange for local officials or visiting dignitaries to make site visits to exemplary subrecipients.

□ **Contingency Awards**

*Plan on making extra funding available for subrecipients that surpass their goals and achieve outstanding performance.* You can set aside funds in activity categories beyond what is initially obligated to specific subrecipients. Your written Agreement with subrecipients can include incentive clauses stating that documented levels of performance within a specified timeframe will automatically result in supplemental funding for the activity area in which the subrecipient has excelled.

Alternatively, you might invite a select group of top-performing subrecipients to compete for extra funding under a contingency-funded bonus round. Subrecipients also might be requested to propose new activities that would make use of the money or be permitted to use funds not normally available to them (e.g., program income).

*In all such cases, however, the grantee would need to satisfy the citizen participation requirements of the CDBG program with respect to the new or increased activities.*

**LEARNING FROM  
MISTAKES: YOUR  
COMMITMENT TO  
CONSTANT  
IMPROVEMENT**

In addition to providing rewards for improved or superior performance, you also need to pay attention to the way you respond to subrecipients' mistakes. All subrecipients make mistakes; what is important is that they learn from the experience so they can improve their performance.

If you create an environment where subrecipients are afraid to acknowledge mistakes and learn from them, very little improvement is going to take place. Instead, subrecipients will devote much of their energy to denying there is a problem or arguing the problem wasn't their fault. You then have to take extra time getting the subrecipient to admit that a problem exists. If subrecipients end up

thinking you were the cause of their problem, they may remain angry with you long after they have forgotten what the issue was all about.

The key to preventing this kind of deadlock is to take a balanced approach. Don't treat the problem too casually, or the subrecipient may conclude that its performance doesn't matter that much. However, don't be too harsh in your response; otherwise the subrecipient may become reluctant to raise issues or ask questions that should be dealt with right away.

*Treat subrecipient mistakes as opportunities to correct weaknesses, and support the subrecipient in improving its operations.* If a subrecipient refuses to learn from the experience and persists in repeating the mistake, then you may have to consider using sanctions. But you have to be very clear with your subrecipients about the conditions under which sanctions will be imposed.

The grantee must also keep in mind, however, that ultimately it is responsible for anything the subrecipient does with CDBG funds. If HUD decides to disallow costs incurred by a subrecipient, the grantee must "settle up," and then decide if it wants to pass the disallowance on to the subrecipient.

### **THE PRINCIPLE OF PROGRESSIVE SANCTIONS**

In applying sanctions, you want to use the least amount of punishment needed to get the subrecipient to take corrective action. This *principle of progressive sanctions* involves a gradual escalation of penalties for continued poor performance, while affording the subrecipient a reasonable opportunity at each stage to settle the problem *before* more serious sanctions are considered.

The success of progressive sanctions depends on your taking two steps:

- First, you must identify and discuss problem areas in the subrecipient's operations as early as possible.
- Second, you have to communicate clearly and effectively to the subrecipient the standards for correcting those problems and the consequences for failing to meet these standards within a prescribed period of time.

The progressive sanctions approach has several benefits:

- Most problems can be resolved when they are still minor, thereby putting the least amount of stress on both you and the subrecipient;
- If the subrecipient continues to refuse to take corrective action, you can prove to other interested parties (such as local elected officials or other subrecipients) that you have given the

*The principle of progressive sanctions requires that you always specify a timetable for improvements, setting forth:*

- ❑ *the corrective actions required; and*
- ❑ *the deadlines when they must be implemented.*

*Without a timetable, the targets for improvement will remain unclear.*

subrecipient every possible consideration before imposing serious penalties; and

- With a gradual approach to sanctions, you can demonstrate to HUD that you are pursuing a reasonable, yet serious, course to get the subrecipient to address its deficiencies in a timely manner.

The strategy of progressive sanctions offers a dramatic contrast to the approach taken by the grantee in Case #3 (Parva) described at the beginning of this chapter. There, subrecipients received no prior notification that the grantee was considering serious sanctions, or even that the grantee no longer considered their past practice to be acceptable. Consequently, they had neither opportunity nor incentive to improve their operations before the sanctions were imposed.

You can apply progressive sanctions in a series of stages, from simply making a subrecipient aware of its operational weaknesses all the way to disallowing its expenses or terminating its activities. The following provides a description of three stages of progressive sanctions.

#### **Stage I: Early Warning/Early Response**

Stage I begins when the subrecipient's difficulties have just come to your attention. Your tracking and monitoring systems should be able to bring the problem to light before it presents serious financial implications for the subrecipient.

At this initial stage, after you verify the nature and extent of the problem, your first task is to communicate to the subrecipient the nature of the problem, what needs to be done to correct it, and what assistance you can provide to help carry out the necessary corrective action. You should develop and notify the subrecipient about a timetable for corrective action.

You have three main options for implementing an intervention strategy:

- (1) ***Plan an intervention strategy with the subrecipient that involves additional training or technical assistance.*** In this response, you assume some of the responsibility for helping the subrecipient to correct the problem. Although this response may require staff time not readily available, the time spent can be both effective in solving the problem and beneficial in enhancing your relationship with the subrecipient.
- (2) ***Require more frequent or more thorough reporting by the subrecipient.*** This imposes a mild sanction on the subrecipient, while improving your ability to track the subrecipient's progress or regulatory compliance. The strategy sends a clear message to the subrecipient that you are going to monitor its activities closely.

*Follow up a monitoring visit:*

- *With additional communications, technical assistance or training;*
- *additional monitoring if a problem is detected and/or is found; and*
- *extra reporting by the subrecipient if a problem is found.*

**Stage II: Intervention for More Serious or Persistent Problems**

*Grantees may find it necessary to disallow the expenses of a subrecipient, or place a subrecipient on probationary status for non-performance.*

- (3) ***Conduct more frequent on-site monitoring or follow-up monitoring of the subrecipient.*** This is an effective action for somewhat more serious or widespread deficiencies in a subrecipient's operations. While it requires additional effort on your part, it communicates that you view the matter very seriously. Give the subrecipient a specific period of time in which to correct the problem, and then review progress on-site to ensure that the subrecipient properly implemented the required corrective action.

If the support and milder sanctions you impose in Stage I don't work, you may have to take more decisive action. You may also want to skip Stage I and move directly to Stage II for subrecipients that you discover have serious or widespread problems that demand an emphatic response. For example, a new subrecipient may have initiated activities before receiving environmental clearance, may have failed to initiate adequate income documentation for beneficiaries, or may not have adequately inspected "completed" work in its housing rehabilitation activities before allowing the units to be occupied and/or authorizing final payment to contractors.

Some of the possible actions you might consider at this stage are:

- ***Restrict the subrecipient's payment requests.*** You can restrict the frequency of requests or the budget line items for which the subrecipient can request payment. You can also increase the documentation the subrecipient must provide with its payment requests before you will approve them. Through this mechanism you can "micro-manage" the subrecipient's implementation of corrective action.
- ***Disallow subrecipient expenses (or require repayment).*** This is a severe sanction, since many subrecipients have very limited unrestricted funds for making repayments. In some cases (as when a subrecipient incurs program expenses prior to environmental review clearance), you may have no option other than to disallow the expenses. In other instances, you might allow a subrecipient to provide additional documentation to validate an expense or find some other way to avoid the disallowance, but usually on the condition that the subrecipient make a dramatic reform in its operations.
- ***Impose probationary status.*** You can take this step when a subrecipient has significant or widespread shortcomings in its operations and has ignored your efforts to bring about corrective action. With this step, you are giving notice that you will terminate the subrecipient if it doesn't correct its problems.

**Stage III: Red Alert**

*Performance problems are a common reason for not renewing a subrecipient in a subsequent program year for performance reasons. Many grantees have had cause to either suspend or terminate a subrecipient prior to the end of a program year.*

Stage III includes “last ditch” measures to turn around the situation with a poorly performing subrecipient. Possible actions include:

- **Temporarily suspend the subrecipient (or the activity being carried out by the subrecipient).** This action should help convince the subrecipient that you “mean business.” However, an action of this severity also suggests that the subrecipient's operations are in such bad shape that you will need to provide intensive technical assistance to get the subrecipient's systems working properly.
- **Do not renew the subrecipient the next program year.** This is often the easiest approach to “terminating” a badly performing subrecipient, but you have to be careful not to wait until next year if there is a significant danger of continued mismanagement or misuse of funds in the current program year.
- **Terminate the subrecipient in the current program year.** If you plan to take this action, first review the language of the written Subrecipient Agreement regarding termination (allowable reasons for termination, rights of appeal, access to and maintenance of records, computation of compensation due in the event of termination, disposition of property bought with CDBG funds, and the general liability of the subrecipient).
- **Initiate legal action.** You may need to follow termination with legal action in order to gain control of program funds, records, and property, or to get back improperly spent funds.

**SUMMARY**

This chapter has presented techniques for following up the results of your subrecipient monitoring. The goals of follow-up are to make sure that subrecipients implement the corrective actions you specify in your monitoring letters and to reward subrecipients who improve their performance and comply with CDBG regulations. You will not be alone if you find you must suspend, terminate, or not renew a subrecipient. The majority of CDBG grantees have had to take similar positions for performance reasons.

*Without effective follow-up, monitoring will have little impact on improving performance and achieving regulatory compliance.*

Effective follow-up is based on five principles:

- The accountability of subrecipients;
- The clarity and consistency of performance standards;
- The clarity and consistency of corrective actions;
- The continuous provision of feedback; and
- Timely communications with subrecipients.

In cases where the interpretation of regulations is changing, you can avoid follow-up problems by taking a conservative approach in the selection of subrecipients and the awarding of grants or loans. Follow-up is easier if you verify the subrecipient's qualifications according to standard selection criteria (*before award*); specify measurable performance expectations in a written Agreement; share your findings and concerns with key elected officials; and point out to these officials the risks of HUD sanctions on your entire program if the subrecipient does not take appropriate corrective actions.

You should follow up your subrecipient monitoring with rewards for superior or improved performance, and sanctions for poor performance or noncompliance. Rewards can include acknowledgement and praise among peers, public recognition, and additional funding. Sanctions should be progressive and reflect three stages. Stage I involves the early identification of problems and moderate intervention to provide more training or technical assistance, more frequent reporting, and more frequent monitoring and follow-up. Stage II sanctions (for continuing or more serious problems) may involve restricting reimbursements, disallowing program expenses, and imposing probationary status. In Stage III, the most serious sanctions include temporary suspension of activities, non-renewal of the subrecipient for the following program year, or (as a last resort) immediate termination in the current program year.

*Case 4:* As the new CD Director, Sheila Bollings had been warned that the monitoring results for The House of Daniel would be disastrous. The numerous repeat findings showed the warnings were right. There were still no consistent records to verify how many people the church-based meals program was serving, whether these services were being offered on a non-denominational basis, and how costs of staff and indirect expenses were being allocated to the activity. There was no IPA audit and only sporadic bookkeeping. Reverend Watson, now 72 years old, had not set up a separate bank account for CDBG funds. As a result, donations and grants from other sources for various church-sponsored activities could not be tracked separately from CDBG-funded activities. Several members of the House of Daniel's Board of Directors were also local suppliers to the program. The Reverend's strong political support in the neighborhoods and in City Hall, and the small size of the program (\$15,000) meant that the CD Office would have difficulty imposing any serious sanctions to bring about corrective action.

*In this situation, Sheila decided not to confront the Reverend with a threat of disallowed costs, but rather to implement a six-month intervention strategy involving three steps. First, her staff immediately set up a three-week training and technical assistance program with the Reverend and his staff to overhaul the House of Daniel's books, to establish a monthly accounting and reporting cycle, and to devise a cost allocation plan. Second, Sheila and the Reverend together wrote a new Statement of Work for the coming year's Agreement that identified specific performance targets for the program that could be easily measured and reported on a monthly basis, as well as monitored quarterly. This revised Statement became part of the formal Application for Funding for the next program year. Third, with the Reverend's permission, Sheila invited the city council member from the district, and the House of Daniel Board of Directors, to attend an evening planning and orientation session for House of Daniel staff before the annual notification of CDBG Grant Awards. All staff members were reminded of the goals for the coming year and the particular regulations that should be observed. Everyone was optimistic that the goals would be achieved.*

*Six months later, the well documented achievements of the program were even greater than originally planned.*

**NOTES:**

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## **COMMON SUBRECIPIENT MONITORING PROBLEMS**

### **Common Problem Area #1: Program Income**

“Program income” refers to any gross income received by a grantee or subrecipient that was directly generated from the use of CDBG funds. Some common sources of program income include:

- **payments of principal and interest** on loans made with CDBG funds;
- proceeds from the **sale of loans**, or of obligations secured by loans, which were made with CDBG funds;
- funds collected through **special assessments** made against properties owned and occupied by households that are not low or moderate income in order to recover part or all of the CDBG portion of a public improvement;
- **proceeds from the sale or long-term lease** of equipment purchased, or of real property purchased or improved with CDBG funds; and
- **gross income from the use or rental of real property** constructed or improved with CDBG funds, less the costs incidental to the generation of such income

### **General Regulatory Requirements**

The primary regulations regarding program income are found at 24 CFR 570.500(a), 570.503 and 570.504. A guiding principle is that **program income funds are subject to all applicable regulations governing the use of CDBG funds**. The written agreement with the subrecipient must specify whether any program income received by the subrecipient is to be returned to the grantee or retained by the subrecipient and, if the latter, for what CDBG-eligible activities such program income will be used. The financial records of the subrecipient (as well as the grantee) must include complete information on the receipt and expenditure of program income.

Program income must be used before drawing down additional grant funds, unless the program income is in an approved revolving fund, in which case it must be used for the specified purpose of the revolving fund before further drawdowns for that specified activity. At the end of the term of the Agreement, program income on hand or subsequently received by a subrecipient must be returned to the grantee.

### **Three Typical Problems**

#### **1) Improper collection/retention of program income**

- Subrecipient treats interest earned on cash advances or on funds in a revolving account as program income, rather than remitting to the grantee for return of such interest income to the U.S. Treasury.
- Subrecipient retains program income without grantee permission, or uses it in violation of terms of Agreement.
- Program income in a revolving fund account is not used prior to drawing down additional funds for that activity.

- Subrecipient improperly disposes of property a year after purchase and fails to ensure sale at fair market value (the amount of program income due the grantee is the current fair market value of the property).
  - When property that is only partially financed with CDBG funds is rented or sold, the CDBG program does not receive its fair share of proceeds generated.
  - Program income is not returned at expiration of subrecipient agreement.
  - Failure to repay CDBG funds for property acquired or improved with CDBG funds in excess of \$25,000 when use changes and when new use does not meet a National Objective for the required time period.
- 2) **Improper utilization of program income**
- Program income is treated by subrecipient as unrestricted funds.
  - Program income is spent on an activity that is not eligible under CDBG rules.
  - Program income is used for an activity that the grantee has not approved via the Agreement.
  - Program income is not used in compliance with all applicable regulations.
  - The subrecipient draws down program funds without using program income first.
- 3) **Improper recording and reporting of program income**
- Subrecipient's financial records do not describe receipt and use of program income in an accurate, complete, and timely fashion.
  - Subrecipient has an inadequate system to monitor repayment or sale of loans that it has made with CDBG funds.
  - Information on the status and use of program income reported to grantee by subrecipient is inaccurate or untimely.

**Useful Strategies for Avoiding Problems with Program Income**

- (1) Have a detailed explanation of program income requirements in your written Agreement with each subrecipient.
- (2) Provide technical assistance to subrecipients in setting up their record-keeping systems to capture data on program income.
- (3) For those subrecipients operating loan programs, provide technical assistance to ensure adequate loan documentation and loan servicing systems.

- (4) Require detailed program income information as part of regular progress reports and drawdown requests from subrecipients, with periodic on-site “spot-checking” of records by the grantee to confirm the reported data.

Technical assistance with early intervention to identify problems while they are still quite small is particularly important with respect to program income. In the event that the subrecipient has misspent program income, a grantee may have no option other than to disallow the related expenses. A disallowance is likely to represent a severe burden to a subrecipient and can impose a serious strain on the grantee's relationship with the subrecipient.

Ideally, any program income issues encountered with subrecipients will be of a minor and correctable nature. However, if the subrecipient is not responsive to directed corrective action, and/or persists in viewing the program income as “its own money,” the grantee needs to act expeditiously to curtail the subrecipient's authority to retain and use such funds.

**FOR ADDITIONAL GUIDANCE ON USE OF PROGRAM INCOME, GRANTEES SHOULD CONSULT THE RELEVANT FEDERAL REGULATIONS (24 CFR 570.500(a), 570.503 AND 570.504).**

**Common Problem Area #2:  
Meeting a National Objective for Economic Development Activities**

Many grantees and subrecipients run into difficulty in documenting achievement of a CDBG National Objective when providing economic development assistance to a for-profit business. Economic development activities directed to for-profit businesses can only be undertaken if they meet one of the three National Objectives.

**NATIONAL OBJECTIVE: BASIS FOR QUALIFYING (AND EXAMPLES)**

**Low/Moderate Income Benefit**

**L/M Area Benefit**

Assistance is being made to a **commercial** business that serves a L/M **residential** area. (Example: assistance to neighborhood businesses such as grocery stores or laundromats.) See 24 CFR 570.203, 570.204, 570.208(a)(1), and 570.506(b)(1) and (b)(2).

**L/M Jobs**

Assistance is directly linked to **the creation or retention of permanent jobs, at least 51 percent of which (on a full-time equivalent basis) are to be held by, or made available to, low- and moderate-income persons.** (Example: assistance to a manufacturer for plant expansion that will create permanent jobs, at least 51 percent are for L/M income persons.) See 24 CFR 570.203, 570.204, 570.208(a)(4), and 570.506(b)(1), (5), (6) and (7).

**Slums or Blight**

**Slum or Blighted Area**

The assistance is directed to a business in a designated slum or blighted area and **addresses one or more of the conditions that contributed to the deterioration of the area.** (Example: a low-interest loan as inducement for a firm to locate in a redeveloping, blighted area.) See 24 CFR 570.203, 570.204, 570.208(b)(1), and 570.506(b)(7) and (9).

**Spot Blight**

Assistance that is provided to a commercial or industrial business **outside** of a designated slum or blighted area, **but which:** (1) is designed to eliminate specific conditions of blight or physical decay; and, (2) where the use of CDBG funds is specifically limited to the cost of **acquisition, clearance, relocation, historic preservation, or building rehabilitation** (and the rehabilitation is limited to actions necessary to eliminate the specific conditions detrimental to public health and safety). (Example: demolition of dilapidated structure owned by a business to make room for a new commercial building.) See 24 CFR 570.203, 570.204, 570.208(b)(2), and 570.506(b)(10).

**Urban Renewal Completion**

Assistance is to a commercial or industrial business **located in an Urban Renewal project area** (or a Neighborhood Development Plan action area designated under Title I of the Housing Act of 1949), and is **necessary to complete the urban renewal plan.** (Example: loan to

a business to complete facilities consistent with urban renewal plan.) See 24 CFR 570.203, 570.204, 570.208(b)(3), and 570.506(b)(11).

**Urgent Needs**

Assistance to a business as part of an activity designed to alleviate existing conditions that the grantee has certified pose a serious and immediate threat to the health or welfare of the community, are of recent origin (or recently became urgent), and the grantee cannot finance the activity on its own and other sources of funds are not available. (Example: a loan to reconstruct the only grocery store, a small locally owned market, in a remote area of the urban county that was severely damaged in an earthquake, where other resources [local, FEMA, Small Business Administration] are insufficient or unavailable to address this imminent threat to the community.) See 24 CFR 570.203, 570.204, 570.208(c), and 570.506(b)(12).

Among the three National Objectives, the documentation required for activities undertaken to address conditions of **slums or blight** are somewhat less complicated than that required for activities designed to address other objectives (low/moderate income benefit, urgent needs). For this reason some grantees and subrecipients seek to reduce their record-keeping requirements by providing economic development assistance to for-profit businesses under the slums/blight objective. However, grantees are still required to ensure that, over the one-, two-, or three-year period certified by the grantee, 70 percent of their CDBG expenditures are for activities that principally benefit low- and moderate-income persons. This requirement constrains a grantee's ability to conduct economic development activities under the National Objectives of “slums or blight” and “urgent needs.” By definition, the “urgent needs” category can be justified in only very limited circumstances.

Job creation for low- and moderate-income persons is a critical element of local revitalization strategies in many communities experiencing economic problems. In using CDBG funds for job creation, grantees have to be careful to map out specific ways to meet the record-keeping requirements for demonstrating low/moderate income benefit **before** funds are provided to a subrecipient.

**LOW- AND MODERATE-INCOME BENEFIT DOCUMENTATION REQUIREMENTS**

In assisting for-profit businesses, the requirements for documenting benefits to low/moderate income persons depend upon the type of activities undertaken:

**For job creation activities:**

Where the subrecipient (or grantee) chooses to document that at least 51 percent of the jobs will be **available to** low- and moderate-income persons, documentation must include:

- a **written agreement** containing: a commitment of the business to make at least 51 percent of the jobs, on a **full-time equivalent basis**, available to low- and moderate-income persons and to provide training for any such jobs requiring special skills or education; a listing by job title of the permanent jobs to be created, indicating which will be made available to L/M persons, which ones are part-time, which jobs require special skills and education; and a description of actions to be taken by subrecipient (or grantee) and business to ensure that L/M persons are given **first consideration** for those jobs; and

- a **listing by job title of those permanent jobs that were filled** and which of those were **made available to** L/M persons; a description of how **first consideration** to such persons was given, including an explanation of the **hiring process**, which L/M persons were interviewed for each job, and which were hired.

Where the subrecipient (or grantee) chooses to document that at least 51 percent of the jobs **will be held by** low- and moderate-income persons:

- a copy of a **written agreement** containing: a commitment by the business that at least 51 percent of the jobs, on a **full-time equivalent basis**, will be held by L/M persons; and, a listing by job title of the permanent jobs to be created, identifying any that are part-time;
- a listing by job title of **permanent jobs filled** and which were **initially taken by** L/M persons; and
- for each L/M person hired, the family size and annual income of the person's family prior to being hired, or evidence that they may be presumed to be a L/M person under 24 CFR 570.208(a)(4)(iv).

**For job retention activities:**

- **objective evidence** that in the absence of CDBG assistance the jobs would be lost;
- a listing by job title for the business showing **which permanent jobs were retained**, which were part-time, which are known to be held by L/M persons, which other jobs are projected to become available to L/M persons over the next two years due to turnover, and **on what basis the turnover is being predicted**;
- for each retained job held by a L/M person, information on the size and annual income of the person's family, or evidence that they may be presumed to be a L/M person under 24 CFR 570.208(a)(4)(iv);
- for jobs claimed to be “available to” L/M persons through turnover, the information cited above as that required for “available to” job creation activities; and
- for jobs claimed to be “available to” L/M persons through turnover, a listing of each job that has turned over to date, identifying which actually were **taken by** or **made available** to L/M persons, and for the latter, how **first consideration** was given to such persons.

**For area benefit activities** (providing assistance to commercial businesses serving a low- and moderate-income residential area):

- provide a **definition of service area** with respect to geographic limits, census tract block groups, and/or neighborhood names;
- **identify the percent of the residents of the service area who are L/M persons** pursuant to 24 CFR 570.208(a)(1)(vi) or demonstrate that the area qualifies under 570.208(a)(1)(vii);
- where applicable, demonstrate that the percent of residents in the service area who are L/M persons qualifies under the exception criteria because it falls into the upper quartile of the city/county per 24 CFR 570.208(a)(1)(ii); and

- provide evidence of the residential character of neighborhood.

### **SUGGESTIONS FOR SATISFYING DOCUMENTATION REQUIREMENTS**

The documentation requirements can be extensive, particularly if the subrecipient (or grantee) is dealing with a business with little or no prior experience with the regulatory requirements of a Federal assistance program. There are a number of steps that a subrecipient (or grantee) can take to reduce the likelihood of inadequate National Objective documentation relative to low- and moderate-income benefits:

- 1) **Be clear** with the subrecipient and the business concerning the documentation requirements from the very first contact (at the outreach and application stage).
- 2) Incorporate a **detailed description of the documentation requirements in the assistance agreement** with the business, including **provisions for recapture** of the assistance in the event that the business fails to honor its commitments and responsibilities under the agreement.
- 3) Before the assistance agreement is executed, develop with the business the **specific procedures and forms** that will be employed to capture the desired information.
- 4) In terms of job creation goals, make every effort to **ensure that the business is not promising more than it can deliver**. As long as the level of assistance per job created is reasonable,\* it is better for the business to propose to develop 11 L/M jobs out of 20 created (for 55 percent L/M benefit) and to meet this goal, than it is to promise 20 L/M jobs out of 30 created and to only achieve 14 L/M jobs (47 percent L/M benefit). Nevertheless, the HUD standard is **51 percent of whatever number of jobs are created**.
- 5) Even if the business proposes to achieve the L/M benefit for job creation through hiring L/M persons, the assistance agreement should stipulate that **documentation must also be collected for jobs “made available to” L/M persons**; this information may be used as alternate documentation in the event that the business fails to fill some of the jobs with L/M persons that it expected to.
- 6) Many businesses are not accustomed to capturing information on family size and income from job applicants. It may also be that their typical applicant pools have a lower L/M percentage than desired. Such businesses should give serious consideration to securing **referrals through a local agency** that has a L/M income clientele and is experienced at collecting such data (for example, the local Jobs Training Partnership Act (JTPA) agency or office of the State's department of employment security or department of labor).
- 7) Make it a practice of **obtaining the job applicants' addresses** and determining whether they live in an area that would enable a presumption of L/M status before checking their actual income status (thus eliminating the need to determine their family size and income when the person lives in an area that qualifies for the presumption).

\* The amount of CDBG assistance per full-time equivalent job must meet the Public Benefit standards under 24 CFR 570.209.

**FOR ADDITIONAL GUIDANCE ON MEETING NATIONAL OBJECTIVES IN ECONOMIC DEVELOPMENT, GRANTEEES SHOULD CONSULT THE RELEVANT FEDERAL REGULATIONS (24 CFR 570.203, 570.204, 570.208, AND 570.506(b)).**