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COMMUNITY DEVELOPMENT

Block Grant Economic Development Activities Reflect Local Priorities

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Resources, Community, and
Economic Development Division

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The Honorable Donald W. Riegle, Jr.
Chairman
The Honorable Alfonse M. D'Amato
Ranking Minority Member
Committee on Banking, Housing, and
Urban Affairs
United States Senate

The Honorable Henry B. Gonzalez
Chairman
The Honorable James A. Leach
Ranking Minority Member
Committee on Banking, Finance,
and Urban Affairs
House of Representatives

This report provides the results of the two studies of the Department of Housing and Urban Development's Community Development Block Grant Program required by the Housing and Community Development Act of 1992 (P.L. 102-550, Oct. 28, 1992). Section 806(c) of the act required GAO to study the proper, efficient, and effective use of grant funds, and section 806(d) required a study of the types and quality of jobs created or retained through the program's assistance.

We are sending copies of the report to the Secretary of Housing and Urban Development and to other interested parties. We will make copies available to others upon request.

This work was performed under the direction of Judy A. England-Joseph, Director, Housing and Community Development Issues, who can be reached on (202) 512-7631 if you or your staffs have any questions. Major contributors to this report are listed in appendix I.

Keith O. Fultz

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Executive Summary

Purpose

To help state and local governments develop viable communities, the Congress has appropriated over $62 billion to the Community Development Block Grant Program since 1975. The Housing and Community Development Act of 1992 (P.L. 102-550) directed GAO to conduct studies addressing the proper, efficient, and effective use of grant funds and the types and quality of jobs the program has helped create or retain. As agreed with the cognizant congressional oversight committees, GAO's specific objectives were to (1) provide information on the funding of economic development activities and the impediments that grantees have experienced; (2) identify issues related to the proper use of these funds; (3) provide information on the types and quality of jobs resulting from program funding and identify possible criteria for measuring job quality; and (4) identify potential performance indicators for measuring the overall effectiveness of economic development activities under the program.

Background

The Department of Housing and Urban Development (HUD) manages the Community Development Block Grant Program. It distributes annual grants using statutory formulas based on communities' needs. Entitlement communities (mostly cities with at least 50,000 people and urban counties) receive direct grants, and nonentitlement communities (located predominately in rural areas) are eligible for state- or HUD-administered "small cities" grants. Grantees have broad discretion, but funded activities must address at least one of three national objectives by (1) benefiting low- and moderate-income people (households earning less than 80 percent of the local area's median income), (2) helping prevent or eliminate slums or blight, or (3) meeting other urgent community development needs. Grantees must spend at least 70 percent of their funds to meet the program's basic intent: benefiting low- and moderate-income people. Economic development, housing rehabilitation, and providing public works improvements and public services are examples of eligible activities. Grantees annually report to HUD information on the activities funded, but because of the timing, HUD's annual program report to the Congress usually reflects the use of grants made 2 or 3 fiscal years earlier.

Results in Brief

Annual appropriations for the Community Development Block Grant Program have ranged from $2.2 billion to $4.5 billion, with a general downward trend in the amounts appropriated in constant dollars. Grant funds targeted to economic development activities have constituted a relatively stable percentage of total program funding: 10-14 percent of total program funding for entitlement communities and 15-22 percent for nonentitlement grantees. Grantees identified three principal impediments to using grants for economic development: confusion over rules and requirements for the grants; the administrative burden of having to document payment of the local prevailing wages for small construction projects; and the difficulty of using grants for job retention activities. Remedies are under way or proposed for the first two impediments, but HUD has not identified a remedy for the third.

The proper use of block grant funds for economic development requires that grantees benefit low- and moderate-income people, appropriately assist for-profit businesses, and safeguard the lending of public funds. HUD's Office of Inspector General, community groups, and others have questioned whether funds have been properly used. To address these issues, HUD expects to issue proposed regulations in March 1994 to help grantees select economic development activities and assess their public benefits, as mandated by the Housing and Community Development Act of 1992, and has begun to collect data on loan defaults.

Because local economic conditions and economic development strategies differ, program funds have been used to support many types of jobs, and there are no generally accepted federal criteria for defining job quality. Because the Congress built local discretion into the program, GAO believes that establishing standards for either job quality or the overall effective use of economic development funds is best left to local communities. However, GAO has identified potential indicators of job quality (such as pay and promotion potential) and overall effectiveness (such as the characteristics of jobs resulting from the program and the amount of other funds leveraged). If these potential indicators are further refined, communities might find them useful. And although HUD will soon be publishing proposed guidelines to help grantees better define overall performance indicators for economic development, grantees might also benefit from learning about the procedures and criteria other grantees have used in promoting job quality.

Principal Findings

Several Factors Affect the Use of Program Funds for Economic Development

Economic development activities have centered on financial assistance to businesses. The grant amounts that entitlement communities spent for this purpose generally decreased between 1984 and 1990 (a trend not seen among nonentitlement grantees). In fiscal year 1990, about 450 entitlement communities spent $290 million in program funds for economic development, but 45 percent of these expenditures were made by 20 grantees. The pattern was similar in fiscal years 1988 and 1989, but not necessarily for the same grantees. During 1989, 1990, and 1991, 10 state-administered grant programs (again, not necessarily the same ones) accounted for about 60 percent of the program funds allocated to economic development.

Local officials and representatives of national interest groups identified three conditions that have impeded the use of funds for economic development. HUD is beginning to provide additional training to program staff to address the first impediment: inconsistent interpretation of program rules by HUD's headquarters and field offices. The President's National Performance Review has recommended action that would ease the second impediment by raising, from $2,000 to $100,000, the dollar threshold governing construction projects subject to the Davis-Bacon Act. This act requires that contractors on federally funded government construction projects pay the area's prevailing wage rates. The third impediment is the difficulty communities encounter in using grants to help struggling businesses retain existing jobs. Currently, recipients must document that the threatened jobs would be lost without the assistance and that at least 51 percent are held by (or could be turned over to) low- and moderate-income people. HUD began reevaluating these requirements several years ago but has taken no action since January 1993, when it received what officials characterized as limited input from four national associations.

Proper Use of Economic Development Funds Has Been Questioned

Grantees may not be consistently meeting two key requirements that govern the proper use of grant funds. First, some economic development activities have not met the requirement that at least 51 percent of the jobs created or retained must either be taken by, or made available to, low- and moderate-income people. Second, assistance provided to some for-profit businesses has not met an appropriateness test. This test should show, among other things, that the assistance is not excessive relative to the business's needs or the expected public benefit. HUD's Inspector General and others have found many instances in which grantees did not adequately perform or document actions to ensure compliance. The Housing and Community Development Act of 1992 has eased these requirements and instructed HUD to issue guidelines to help grantees select economic development activities and assess their public benefits. By

March 1994, HUD expects to issue proposed regulations containing the guidelines for public comment.

Grantees often provide economic development assistance to for-profit businesses in the form of loans that must be repaid to the grantee. The number of defaults on these loans, along with the amount of program funds thus put at risk of loss, is another issue related to the proper use of block grant funds. HUD has begun to collect data from grantees nationally on these defaults; these data should be useful to grantees in assessing their own experiences and to HUD and the Congress in assessing the overall seriousness of the situation.

Criteria May Help Measure Job Quality and Overall Effectiveness of Grantees' Economic Development Activities

GAO's review of performance reports for fiscal year 1990 found that the jobs that entitlement grantees said they created or retained were in many different occupations. These occupations fell predominately into 4 of 12 broad civilian job categories used by the Bureau of Labor Statistics: production (26 percent), service (20 percent), administrative support (13 percent), and handlers/equipment cleaners/helpers/laborers (9 percent).

GAO found no generally accepted federal definition of a "quality" job but prepared a list of potential broad indicators of job quality suggested by labor experts. These indicators include, for example, the level of pay, the potential for promotion and pay increases, the availability of fringe benefits such as health insurance, the availability of training to enhance work skills, and the length of the workweek (full- or part-time). However, without a control group or other means of accurately estimating what would have occurred without the grant program, it is very difficult to measure the net effect the program has on either the number or quality of jobs.

GAO also found no generally accepted set of performance measurements for assessing the overall effectiveness of grantees' economic development activities. However, GAO identified the following possible indicators, some of which individual grantees are already using: (1) various job elements (the number of jobs, cost of creating them, type, and targeted population); (2) an increase in the community's tax base; (3) the amount of public and private funds leveraged relative to the amount of loans; (4) the level of defaults on loans made by grantees; (5) the extent to which essential services and facilities are created; and (6) the types and sizes of the businesses assisted.

The Congress chose a block grant program so that it would be flexible, allowing grantees to match the program's resources to their individual local needs. Many grantees, federal officials, and economic development experts view this as the program's greatest strength and believe grantees should be permitted to measure the outcomes of their economic development activities against their local economic goals and development strategies. GAO shares this view. The previously mentioned guidelines that the Congress directed HUD to develop to assist grantees in evaluating economic development activities may also, to some degree, help them establish their own performance measurements.

Establishing job quality criteria is also a task logically left to local communities. Many economic variables can shape grantees' perceptions of job quality and their ability to provide such jobs. These variables include, for example, the skill level of the local work force and the community's relative need for jobs. Many grantees have encouraged jobs with locally desired characteristics by giving these jobs higher priority when selecting projects—a practice GAO believes HUD should encourage.

Recommendations

GAO recommends that HUD (1) periodically assess the effectiveness of the training provided to the HUD officials responsible for monitoring and administering block grant economic development activities; (2) revive efforts to determine whether and how Community Development Block Grant funds could be more easily used for job retention activities; (3) include in HUD's annual report to the Congress the data that HUD is starting to collect on delinquencies and defaults on loans for economic development that grantees make to for-profit businesses; and (4) encourage grantees to establish and apply job quality goals by means such as distributing information on the criteria that other grantees have developed and use.

Agency Comments

GAO discussed a draft of this report with the Director of HUD's Office of Block Grant Assistance and his staff, and they agreed with GAO's findings and draft recommendations. These HUD officials also provided updated information and technical corrections that have been incorporated into this report. As requested by the congressional oversight committees, GAO did not obtain written agency comments on a draft of this report.

Contents

Abbreviations

BLS	Bureau of Labor Statistics
CDBG	Community Development Block Grant
GAO	General Accounting Office
GPR	grantee performance report
HUD	Department of Housing and Urban Development
PER	performance evaluation report
SBA	Small Business Administration
UDAG	Urban Development Action Grant

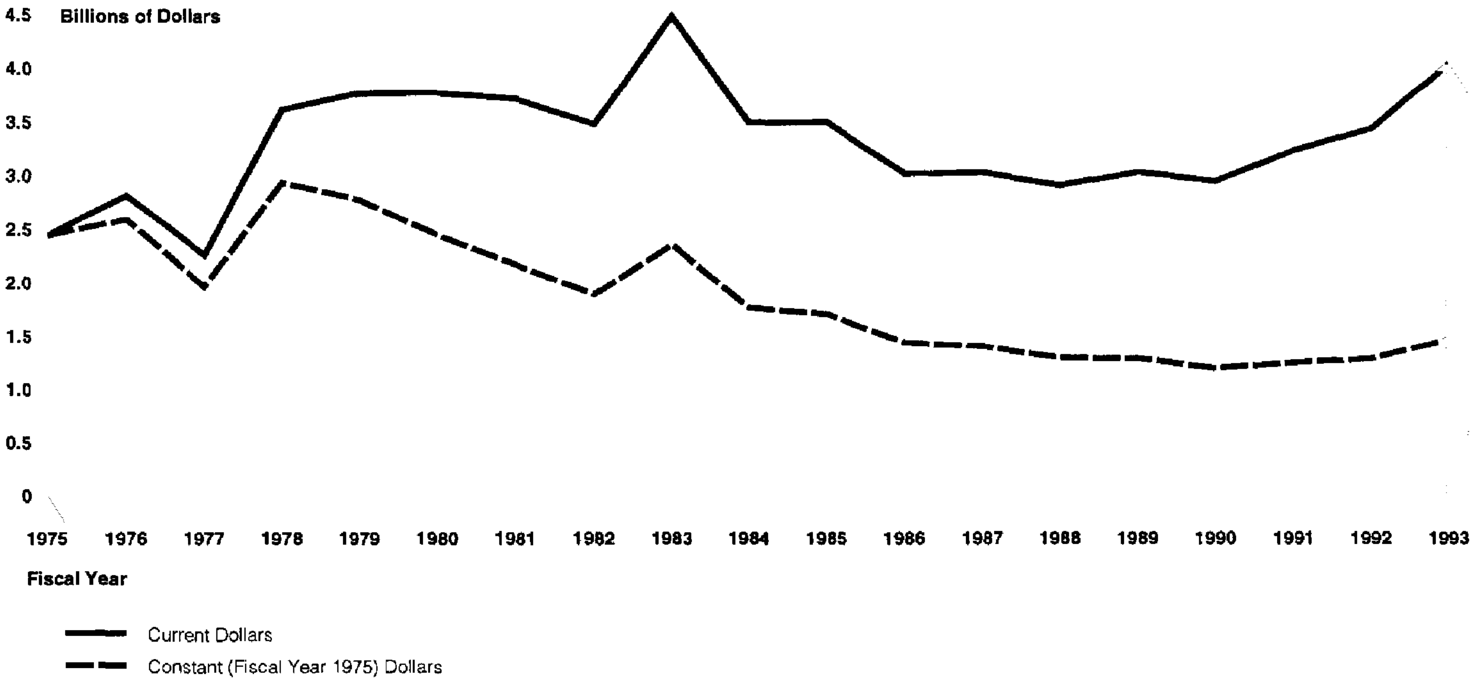
Introduction

The Community Development Block Grant (CDBG) Program, established by the Housing and Community Development Act of 1974, provides annual grants, principally to state and local governments, to aid in the development of viable communities. The program is managed by the Department of Housing and Urban Development (HUD). The levels of the grants are set by statutory formulas that take into consideration various indicators of need. Although CDBG grantees have broad discretion in deciding how to spend their annual grants, they are limited to activities that address one or more of the program's three national objectives. These objectives are to (1) benefit low- and moderate-income people, (2) aid in the prevention or elimination of slums or blight, and (3) meet other urgent community development needs. The activities also must fall into 1 of 25 categories of eligible activities, which include housing rehabilitation, public works, public services, and economic development. Overall, the program is intended to benefit principally low- and moderate-income people. Grantees are required to spend at least 70 percent of their funds on activities benefiting these populations.

Program Funding

Since providing initial funding in 1975, the Congress has appropriated over $62 billion for the CDBG Program. Annual appropriations have ranged from $2.2 billion to $4.5 billion. However, there has been a general downward trend in the constant dollars appropriated. (See fig. 1.1.)

Figure 1.1: CDBG Appropriations in Current and Constant Dollars, 1975-93



Most of the appropriations go to two major programs: the Entitlement Program and the state- and HUD-administered Small Cities Program. Communities participating in the CDBG Program have two other CDBG-related sources of funds that can be used to support these program activities: income generated from their previous CDBG activities (such as repayment of loans) and funds obtained through the Section 108 Loan Guarantee Program. Under the Section 108 Program, HUD guarantees notes issued by the grantee, and the grantee pledges its current and future CDBG grants for the repayment of the guaranteed loan.

Entitlement Program

The Entitlement Program is the largest CDBG Program component, historically representing about 70 percent of CDBG appropriations. The communities that receive annual entitlement grants are generally cities designated as central cities of metropolitan statistical areas, other cities with populations of at least 50,000, and qualified urban counties with populations of at least 200,000 (excluding the population of any entitlement cities within these counties). The grant amount that each entitlement metropolitan city or urban county receives is determined by a statutory formula incorporating several quantitative measures of community need. These measures include population, poverty levels, housing overcrowding, the age of housing, and population growth or decline in relation to all metropolitan statistical areas. In fiscal year 1992, 889 communities—758 cities and 131 urban counties—were eligible to receive entitlement funds.

Although CDBG grants are entitlements, grantees must submit a plan describing the proposed uses of funds and later document how the funds were actually used. The plan, called a "final statement," must be submitted before the applicable program year begins. Within 3 months after the end of this program year, the grantee must submit a grantee performance report (GPR) to HUD to account for how program funds were used.

State- and HUD-Administered Small Cities Programs

The state- and HUD-administered Small Cities Programs are the second-largest program component, receiving about 30 percent of CDBG appropriations. These programs aid communities that do not qualify for assistance under the Entitlement Program. These communities are frequently very small and predominately rural. About 65 percent of fiscal year 1991 funds in the state-administered Small Cities Program were distributed to counties or communities with populations of less than 2,500.[1] The grant is based on the higher of two different needs-based formulas, which include factors similar to those used in the formula for entitlement grants. States (and Puerto Rico) have the option of administering their Small Cities Program or allowing HUD to do so. All but two states have opted to administer their own programs. HUD administers the Small Cities Program for New York and Hawaii.

States choosing to administer their Small Cities Program (hereafter referred to as the State-Administered Program) are required to annually submit a final statement to HUD describing their states' community development objectives and method of distributing funding among eligible communities. States must also submit annual Performance Evaluation Reports (PER). The PERs must include information on which communities were allocated funds, the amount of their grants, the activities being funded, and the national objectives being met by the funded activities.

[1]Information on fiscal year 1991 funding was the latest available and was reported in HUD's fiscal year 1993 Annual Report to Congress on the Community Development Block Grant Program.

Program Income

In addition to annual CDBG grants, grantees may receive program income from previous years' CDBG-funded activities. This income can consist of payments of principal and interest by recipients of loans made with CDBG funds, proceeds from the sale of real property or equipment, or interest earned on funds held in a revolving fund. Program income must be used only to fund eligible activities that comply with all CDBG requirements.

Program income has become a significant source of funds to finance CDBG-eligible activities. According to HUD's data, entitlement grantees received $514 million in program income (about 22 percent of the value of annual grants) in fiscal year 1990, the latest full year for which such information has been reported.[2] The largest amount of program income has consistently come from repayments of housing rehabilitation loans; the second largest has come from repayments of economic development loans.

Section 108 Loan Guarantee Program

Communities and states that receive CDBG grants can, under section 108 of the Housing and Community Development Act of 1974, apply for additional financing in the form of loans. Under this program, HUD guarantees notes issued by grantees for up to five times their current year's CDBG grant. Proceeds from these notes can be used to finance community and economic development projects that are too large to be financed from the grantee's annual grant. Activities funded with Section 108 loans must comply with regular CDBG requirements, and expenditures must be reported to HUD in the grantees' annual GPRs and PERs. Currently, notes issued under the Section 108 Loan Guarantee Program are sold centrally in periodic public offerings conducted by an underwriting group selected through a competitive process.

The National Affordable Housing Act of 1990 made significant changes to the Section 108 Loan Guarantee Program. These changes included expanding the program to nonentitlement communities, increasing the maximum loan repayment period from 6 to 20 years, and increasing the maximum loan amount from three to five times the latest CDBG grant.

Since the program's inception, Section 108 activity levels have varied. In fiscal year 1992 (the latest year for which data are available), HUD approved 46 Section 108 loans totaling $163.8 million—the highest amount since 1982. (See fig. 1.2.)

[2]These data are based on reports from 97 percent of the entitlement grantees.

Figure 1.2: Section 108 Loan Commitments in Current and Constant Dollars, 1979-93

CDBG-Funded Economic Development Activities

Local and state economic development strategies often focus on retaining existing businesses, helping local businesses expand, and encouraging new firms to locate inside local and state boundaries. To support their economic development strategies, state and local governments may use a variety of federal economic development programs, including the CDBG Program, to supplement their own resources. Many economic development activities can be funded under the CDBG Program, including (1) direct financial aid to for-profit businesses; (2) assistance to for-profit businesses for land acquisition, infrastructure development, construction, or rehabilitation; and (3) commercial and industrial improvements by the grantee.

The creation or retention of permanent jobs is one way that a CDBG-funded activity can meet the national objective of benefiting low- and moderate-income persons. However, the job creation or retention activity qualifies under this objective only if 51 or more percent of the created or retained jobs are either taken by or made available to low- and moderate-income people. Low- and moderate-income people are defined as families and individuals whose incomes do not exceed 80 percent of the median income for the local area, as determined by the Secretary of HUD, with adjustments for smaller and larger families. According to HUD's data, communities that receive entitlement grants justify many of their economic development activities on the basis of job creation or retention. Although the State-Administered Program does not collect information specifically on which economic development activities qualify on the basis of job creation or retention, HUD officials believe the vast majority of these activities qualify for the program on this basis.

The Housing and Community Development Act of 1992 significantly affects CDBG-funded economic development activities. Section 806(a) of the act requires HUD to establish, by regulation, guidelines to be used by grantees in evaluating and selecting CDBG-assisted economic development projects. Section 806(b) amends the CDBG legislation by removing certain limitations on CDBG assistance to for-profit businesses: Such assistance no longer may be limited to activities for which no other forms of assistance are available or to activities that could not be accomplished without the CDBG assistance. Section 806(e) allows grantees in certain circumstances to presume that an employee has a low or moderate income. Section 807(c) of the act encourages grantees to reserve 1 percent of their annual CDBG grants for microenterprises—commercial enterprises with five or fewer employees, one or more of whom owns the enterprise.

Objectives, Scope, and Methodology

The Housing and Community Development Act of 1992 (P.L. 102-550) required that we conduct two studies of the CDBG Program. One study, required by section 806(c) of the act, was to address the proper and effective use of CDBG funds and possible impediments to such use. The second study, required by section 806(d), was to address the types and quality of jobs created or retained through CDBG assistance.

As agreed with the cognizant congressional oversight committees, we are providing the results of both studies in this report. Our objectives were to (1) provide data on the extent to which CDBG funds have been used for economic development activities and identify impediments grantees have experienced in using such funds (ch. 2), (2) identify issues related to the proper use of these funds (ch. 3), (3) provide information on the types and quality of the jobs resulting from CDBG funding and identify criteria that might define job quality (ch. 4), and (4) identify possible performance indicators for measuring the effectiveness of CDBG economic development activities (ch. 5).

To obtain data on the extent to which CDBG funds are used for economic development, we reviewed HUD's annual reports to the Congress on the CDBG Program for 1988-93. We also analyzed HUD's computerized data summarizing the individual GPRs and PERs. HUD used these data as the basis for preparing the 1991, 1992, and 1993 annual reports. To obtain information on the types of jobs grantees reported as created or retained through the use of CDBG economic development funds, we reviewed 308 of the 343 GPRs on entitlement grants for fiscal year 1990 in which expenditures were justified on the basis of job creation or retention.[3] While HUD's Office of Inspector General has questioned the accuracy of these GPRs and whether HUD properly reviews them,[4] to our knowledge they provide the best existing information.

To identify impediments that grantees have experienced in using CDBG funds, factors that influence the proper use of economic development funds, and possible indicators of effectiveness, we reviewed audit reports on CDBG activities by HUD's Inspector General issued during the 30-month period ending March 31, 1993. We also analyzed HUD's CDBG regulations and guidance relevant to the funding of economic development activities and recent statutory changes for which HUD has yet to publish proposed regulations. We discussed these issues with HUD officials (including the directors of HUD's Entitlement Division, State and Small Cities Division, Section 108 Loan Guarantee Program Office, Office of Economic Development, and Office of Inspector General) and with community development officials at HUD's Buffalo and New York City field offices. In addition, we interviewed representatives of numerous national and local economic and community development organizations, including low-income advocacy groups, and officials from other federal agencies involved in community development—the Small Business Administration (SBA), the Department of Commerce's Economic Development Administration, and the Farmers Home Administration's Rural Development Agency. We also analyzed documentation we obtained during these interviews.

To determine the key characteristics of jobs created or retained, we extracted job titles from grantees' performance reports and used the Department of Labor's Occupational Outlook Handbook (1992-93 edition) to identify the characteristics associated with these job titles. This publication identifies characteristics such as salary and the potential for

[3]We did not review the other 35 GPRs because they were not available at HUD headquarters.

[4]Multi-Region Review of the Controls Over the Preparation and Use of Grantee Performance Reports, HUD Office of Inspector General, 92-TS-141-0014, July 30, 1992.

advancement for various categories and types of jobs. We relied on this method because information on job characteristics like salary is not systematically collected or reported to HUD by grantees. We also reviewed the final statements submitted by the 49 State-Administered Programs (including Puerto Rico) for fiscal year 1992 to identify the priorities states use in their funding decisions, particularly those designed to indicate job quality. We also discussed the issue of job quality, particularly possible indicators of quality, with experts from the Department of Labor, the Congressional Research Service, labor unions, and business associations.

To obtain a first-hand understanding of issues facing grantees that fund CDBG economic development activities, we visited two cities (Buffalo, New York, and Dallas, Texas), and one urban county (Riverside County, California) in the Entitlement Program, and one state (Michigan) in the State-Administered Program. At those sites, we discussed all our objectives with knowledgeable local officials and reviewed relevant documentation. We judgmentally selected these four grantees because of their high level of expenditures on economic development and geographic distribution, and in order to cover all three major types of grantees (cities, urban counties, and states) in the two programs.

For the purpose of this report, we follow convention in using terms such as "job creation" and "job retention." However, it is very difficult to estimate the creation or retention of jobs that can be attributed to the CDBG Program. From the standpoint of the overall economy, funds used to finance the CDBG Program, if not used for the program, would have funded other government or private activities. This funding, in turn, would have had some employment effects. Strictly speaking, it would be necessary to subtract out the effect on employment that would have occurred in the absence of a CDBG program in order to gauge the CDBG Program's effectiveness. At the local level, an infusion of CDBG funds may be more likely to result in a net increase in employment in that locality because jobs can move between neighborhoods. However, such a result is not a foregone conclusion. It depends on the extent to which similar effects on employment would have been generated anyway. In some cases, the infusion of CDBG funds might lead to more rapid effects on employment at the local level than otherwise would have been the case. These net effects on employment are very difficult to estimate. The fundamental problem is the lack of a control group or the ability to otherwise estimate with some reasonable precision what would have occurred in the absence of a program.[5]

As agreed with the congressional oversight committees, we did not obtain written agency comments on a draft of this report. However, we did discuss a draft of the report with cognizant HUD officials. These officials agreed with our findings and draft recommendations and provided certain updated information and technical corrections that we incorporated into this report. We conducted our review between March 1993 and November 1993 in accordance with generally accepted government auditing standards.

[5]Whether or how CDBG can affect tax revenues or the "quality" of jobs in a community is also difficult to measure for these reasons.

The Use of CDBG Funds for Economic Development Varies and Can Be Impeded by Several Factors

On the local level, economic development activities must compete for CDBG funding with other eligible activities, such as housing rehabilitation and public works. Over the last several years, economic development activities accounted for 10 or more percent of communities' expenditures in the Entitlement Program and over 15 percent of activities funded under the State-Administered Program. Not all communities use CDBG funds for economic development, and spending for this purpose has been concentrated in a small percentage of grantees. Assistance to for-profit businesses was the predominant economic development activity funded, and a wide range of businesses were assisted. Concern has been expressed by some local and national economic development officials that some factors restrict the use of CDBG funds for economic development initiatives. These factors include inconsistent application of HUD's rules, the effect on job retention activities of the requirement that funding benefit low- and moderate-income people, and the low dollar threshold for construction projects to which wage rates established under the Davis-Bacon Act apply.

Communities Have Made Different Choices in the Use of CDBG Grants

As a block grant program, the CDBG Program is designed to provide grantees with maximum flexibility in using the funds to address local needs that are consistent with the program's national objectives. Grantees have used this flexibility to incorporate CDBG grants in a wide range of strategies to achieve their locally determined goals. While many grantees have used CDBG funds for economic development, most CDBG funds for this use have been concentrated on a limited number of grantees.

CDBG Economic Development Competes With Other Eligible Activities

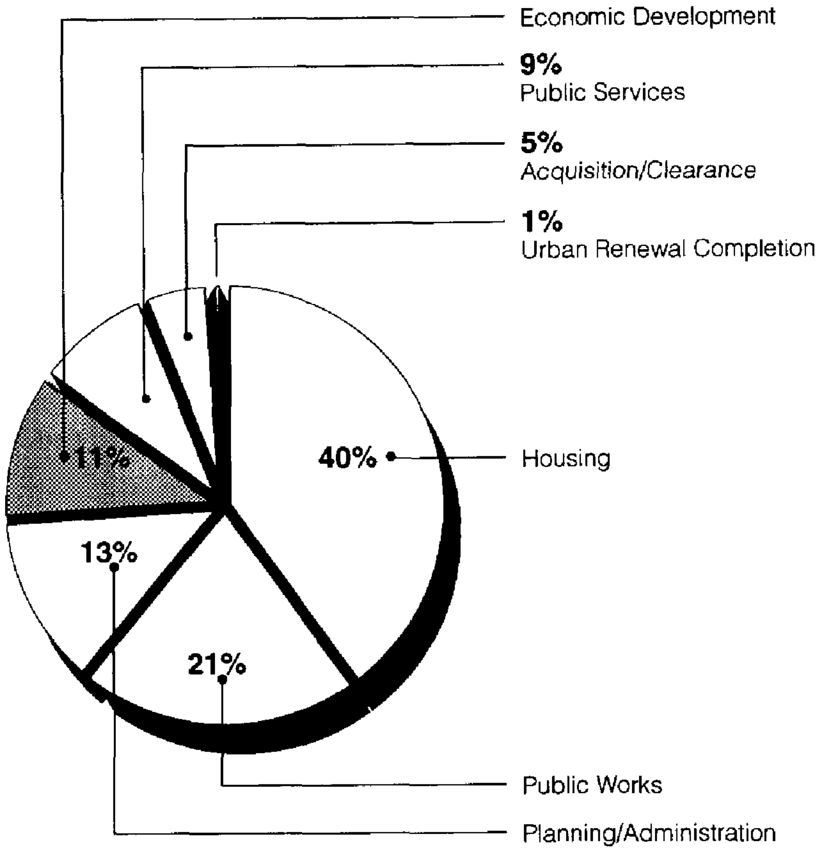
The amount of funding that each CDBG grantee chooses to commit to economic development varies and depends on many local factors. Two major factors are how important economic development is relative to other local priorities and what other sources of funds are available for activities eligible for CDBG funds. According to economic development professionals, in recent years these decisions have become more difficult because inflation has reduced the purchasing power of CDBG funds, and many communities have experienced worsening fiscal conditions.

CDBG grantees have considerable flexibility in deciding how to allocate their CDBG funds among several categories of eligible activities. Economic development is one of seven primary expenditure categories in the Entitlement Program and one of five primary "purpose" categories in the State-Administered Program. Economic development has consistently accounted for about 10-14 percent of expenditures in the Entitlement Program since 1984 and 15-22 percent of planned expenditures in the State-Administered Program since 1982.[1]

In fiscal year 1990 (the latest data available) communities in the Entitlement Program spent the largest percentage of CDBG funds on housing and public works. Economic development was fourth. (See fig. 2.1.)

[1]HUD officials believe that total Entitlement Program expenditures for economic development are understated because some communities may classify economic development expenditures under other categories, such as acquisition and public works. However, the officials could not estimate the extent of the understatement.

Figure 2.1: Entitlement Program Funding by Activity, Fiscal Year 1990

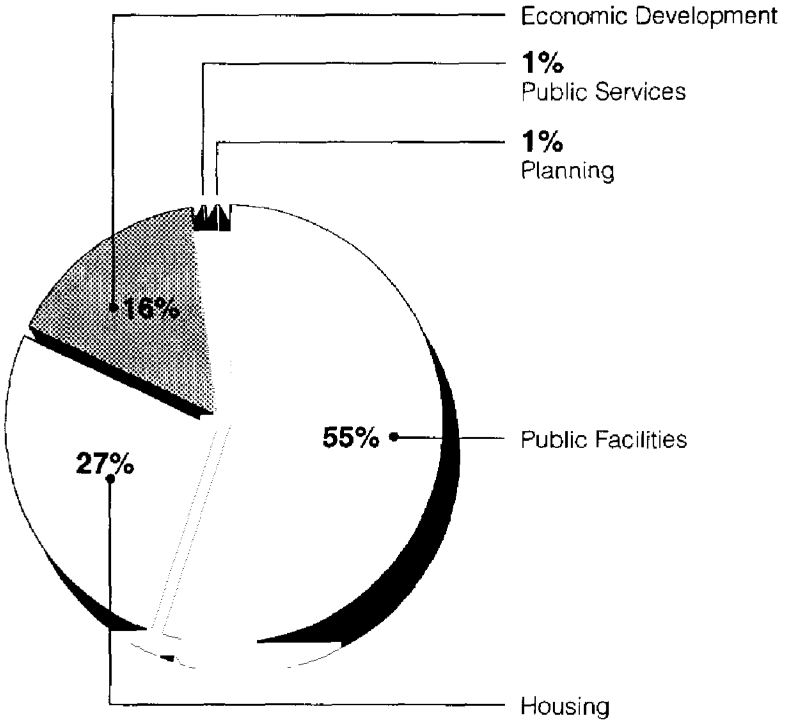


Note: Data are reported expenditures.

Source: GAO's illustration based on data from HUD's 1993 annual report to the Congress on the CDBG program.

In fiscal year 1991, under the State-Administered Program, plans called for spending the largest proportion on public facilities and housing; economic development was third. (See fig. 2.2.)

Figure 2.2: State-Administered Program Funding by Activity, Fiscal Year 1991

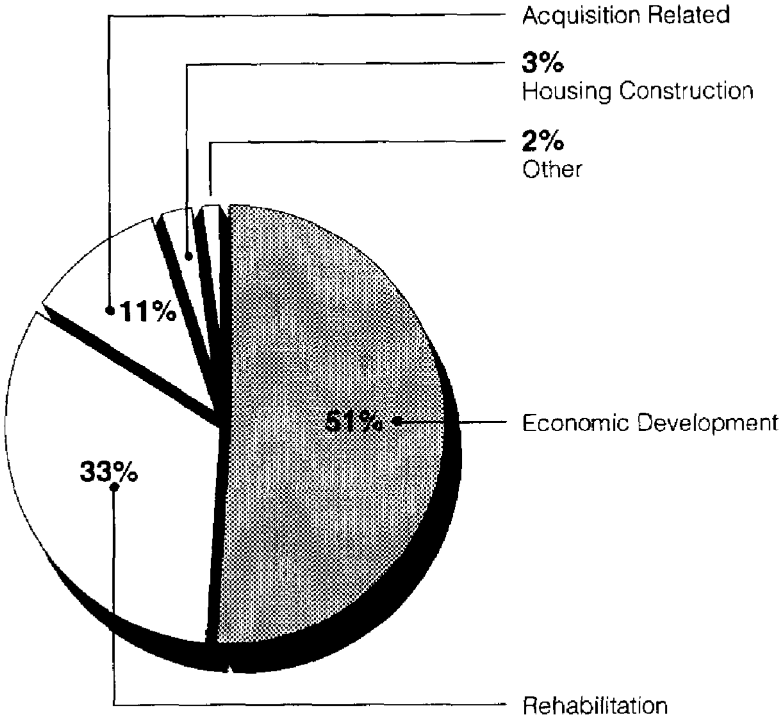


Note: Data are planned allocations. States are asked to provide activity data by general purpose categories. The purpose categories seek to portray what the state and its recipients were trying to accomplish with their CDBG resources.

Source: GAO's illustration based on data from HUD's 1993 annual report to the Congress on the CDBG program.

In contrast, communities that also received Section 108 Loan Guarantee funds chose to spend the largest percentage on economic development. (See fig. 2.3.)

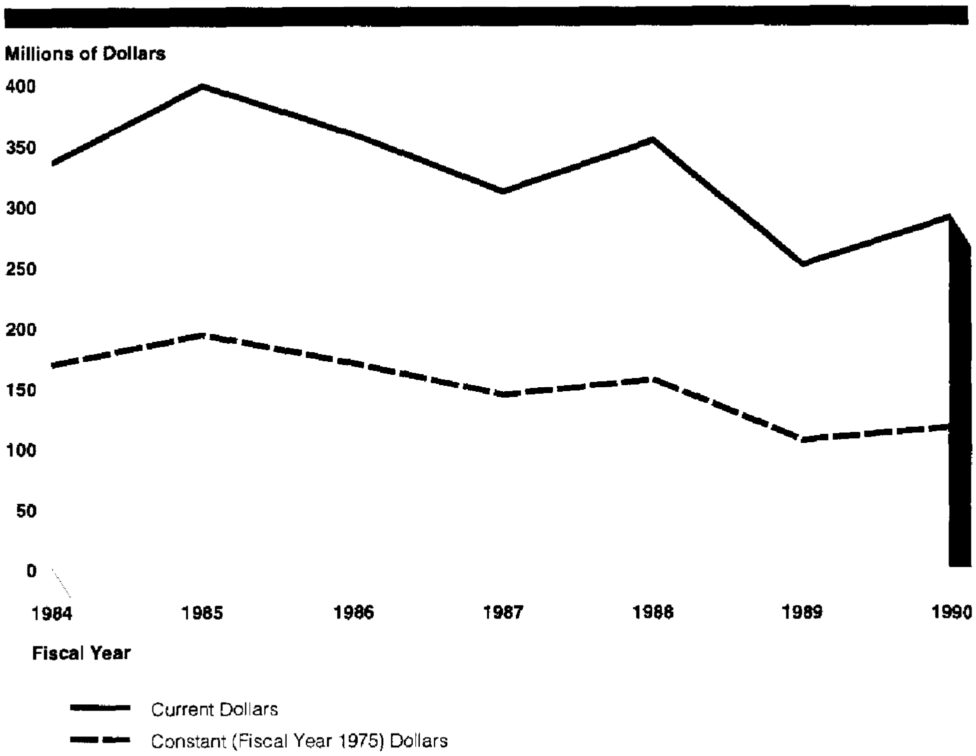
Figure 2.3: Section 108 Funding by Activity, Fiscal Year 1992



Source: GAO's illustration based on data from HUD's 1993 annual report to the Congress on the CDBG program.

Although the percentage of funds used for economic development activities has remained relatively stable in entitlement communities, the total dollar amounts in constant dollars have declined. In its 1993 annual report, HUD reported that in the 5 fiscal years from 1984 to 1988, entitlement communities annually spent an average of $351 million on economic development activities. During fiscal years 1989 and 1990, entitlement communities spent $251 million and $290 million, respectively. (See fig. 2.4.)

Figure 2.4: Entitlement Program Economic Development Expenditures in Current and Constant Dollars, Fiscal Years 1984-90



Source: GAO's illustration based on current dollars from HUD's 1993 annual report to the Congress on the CDBG program. Constant dollars were computed by GAO on the basis of the Consumer Price Index.

The State-Administered Program has remained relatively stable in terms of the current dollars states planned to spend on economic development activities. According to HUD's 1991-93 annual reports to the Congress, at the beginning of each of those planning years, state grantees planned to spend between $125 million and $128 million from each of those years' allocations on economic development activities. Because data on small cities reflect allocations and grantees have several years to draw on a particular year's allocation, states' allocations for any given year may change.[2]

[2]The fiscal year 1989 and 1990 allocations were updated in 1993 to $138 million and $141.4 million, respectively.

CDBG Economic Development Dollars Are Concentrated Among a Limited Number of Grantees

In fiscal year 1990, about 450 entitlement communities had some expenditures for economic development. However, about 45 percent of the $290 million in total economic development expenditures were made by 20 of the entitlement grantees. These grantees were concentrated in the Northeast and in the West. These 20 grantees spent about $130 million on economic development activities in 1990. (See table 2.1.) For 1988 and 1989, a similar concentration occurred, although not necessarily among the same 20 grantees.

Table 2.1: Entitlement Grantees With the Highest Economic Development Expenditures for Fiscal Year 1990

Grantee	Expenditures
Buffalo, N.Y.	$16,325,456
Los Angeles, Calif.	13,828,094
Detroit, Mich.	11,678,655
Newark, N.J.	9,207,352
Philadelphia, Penn.	9,099,119
Luzerne County, Penn.	8,363,933
Rochester, N.Y.	7,294,062
Seattle, Wash.	7,133,287
Dayton, Ohio	7,124,862
Washington, D.C.	6,662,422
Denver, Colo.	5,165,854
Reading, Penn.	4,462,146
Pittsburgh, Penn.	4,066,474
Caguas, Puerto Rico	3,244,249
Jersey City, N.J.	3,140,380
New York, N.Y.	2,797,936
Syracuse, N.Y.	2,736,365
Columbus, Ohio	2,610,322
King County, Wash.	2,523,017
Troy, N.Y.	2,507,483
Total	**$129,971,468**

Most states undertook some economic development activities, but the use of CDBG funds for this purpose was similarly concentrated. Our analysis of HUD's data for the State-Administered Program showed that for 1991, 43 of 49 states used CDBG funds for economic development. However, 10 grantees accounted for over 61 percent of the $128 million[3] allocated for economic development activities. (See table 2.2.) A similar concentration

[3]This amount was erroneously reported as $127 million in HUD's 1993 annual report to the Congress.

occurred in 1989 and 1990, although not necessarily among the same 10 grantees.

Table 2.2: State-Administered Programs With the Highest Economic Development Allocations for 1991

Grantee	Allocations
Michigan	$11,789,879
Wisconsin	11,372,249
South Carolina	9,440,934
Texas	8,191,990
Arkansas	7,316,427
North Carolina	7,256,193
Mississippi	6,963,315
Kentucky	5,509,860
Missouri	5,348,450
Nebraska	5,092,661
Total	**$78,281,958**

Factors That Influence Grantees' CDBG Economic Development Funding Decisions

Many local factors could influence how much CDBG funding an entitlement grantee or a state chooses to use for economic development. These factors include a grantee's emphasis on economic development versus funding other CDBG activities such as housing or public services, the degree to which other non-CDBG funds are available, the grantee's capacity to implement economic development, and the grantee's degree of success in previous economic development activities. Grantees that use the Section 108 Loan Guarantee Program also tend to commit more CDBG funds to economic development, as has been the case with grantees like Buffalo, Rochester, and Syracuse, in upstate New York. These three entitlement communities have historically been active participants in HUD's Section 108 Loan Guarantee Program. Also, as discussed later in this chapter, some grantees may have limited their CDBG-funded economic development expenditures because of inconsistently applied HUD regulations as well as other program provisions perceived as unnecessarily restrictive.

Encouragement from the Congress or the administration is a nonlocal factor that also could influence the amount of CDBG funds grantees use for economic development activities. For example, section 807(c) of the Housing and Community Development Act of 1992 indicates that the Congress would like each grantee to annually reserve 1 percent of its grant for assisting economic development through commercial microenterprises—enterprises with five or fewer employees. The National

Council for Urban Economic Development has recommended that the administration also set an internal goal to encourage communities to allocate resources to economic development.

Economic Development Activities Consisted Predominately of Assistance to For-Profit Businesses

Communities that use CDBG funds for economic development predominantly provide assistance (such as loans) to for-profit businesses. According to HUD's 1993 annual report, entitlement grantees spent $244 million (about 84 percent of their 1990 fiscal year economic development expenditures) on assistance to for-profit businesses. The remaining $46 million was spent on commercial and industrial improvements by the grantee or by nonprofit organizations.

HUD reported that in fiscal year 1991, states allocated $90 million (70 percent of their fiscal year 1991 economic development allocations) to financial assistance to for-profit businesses, either directly or through nonprofit organizations.[4] The remaining $38 million funded a number of activities. The largest amount, $25 million, was spent on infrastructure.

The type of for-profit business receiving assistance varied widely. According to our review of 81 communities' 1990 GPRs, assisted businesses included restaurants, hotels, retail stores, manufacturers, auto repair shops, day care centers, beauty salons, and funeral homes.[5]

Our field visits provided additional information on the types of businesses assisted. For example, Dallas, Texas—a metropolitan city that receives entitlement grants—has an active lending program to provide loans to small businesses. In order to qualify, the business must meet several criteria. However, none limit the type of business seeking CDBG assistance. For example, the business must have operated successfully for 18 months, have less than $2 million in average net income, and not be eligible for 100-percent conventional financing. Businesses assisted through CDBG included a builder of automobile engines, a meat processing plant, a cabinet manufacturer, a produce processor, a barber college, a restaurant, an auto body and repair shop, and a day care center. Likewise, Riverside County, California, used the CDBG program to support a wide range of business activities, including furniture makers, car dealerships, grocery

[4]HUD officials stated that grantees, in their PERs, were reporting financial assistance to for-profit businesses both in the for-profit activity category and in the nonprofit activity category. Grantees were confused about the criteria for these two categories. HUD officials suggested combining these two categories to cover financial assistance to for-profit businesses.

[5]These 81 GPRs were selected for review because they contained narratives that described the type of jobs funded.

stores, printing companies, a paper manufacturer, restaurants, food processing firms, and a warehouse distribution center.

In Michigan, we also identified a variety of businesses being assisted, such as manufacturers of auto parts, furniture, wood products, and electrical fixtures, and food processing and metal fabricating firms. CDBG funds were also used to extend utilities to industrial parks to serve new firms located there.

In the communities we visited, non-CDBG funds were also an important source of funds for supporting economic development activities and were sometimes used in combination with CDBG money. For example, Buffalo, New York, and Dallas, Texas—two metropolitan entitlement grantees—contracted with nonprofit organizations to provide CDBG assistance in the form of loans to businesses. These organizations also used Small Business Administration (SBA) financing to assist business borrowers. At the national level, a 1991 SBA survey found that 66 percent of participants in SBA's 504 development lending program also administer or package CDBG funds.

Grantees Identified Factors That May Restrict the Use of CDBG Funds for Economic Development

Although many local officials and representatives of national interest groups cited the importance of the CDBG Program as a vehicle for stimulating economic development, they also identified what they believed were impediments to the use of the program for this purpose. Specifically, they said that HUD's rules and regulations governing the use of CDBG funds for economic development have been inconsistently applied throughout the country. In addition, they pointed to the requirement that grants benefit low- and moderate-income people, which limited their ability to respond to local needs for job retention and imposed an unreasonable administrative burden because of the need to document compliance. They also said the administrative burdens caused by applying the wage rate provisions of the Davis-Bacon Act to CDBG projects that require construction discourages the use of CDBG funds for economic development activities.

HUD's Guidance Has Been Inconsistently Applied

Local economic development officials said that the inability of grantees to obtain consistent guidance from local and national HUD offices may discourage them from using these funds for economic development or result in noncompliance if they misinterpret the rules. For example, HUD headquarters has said that once individuals are classified as low or moderate income and are hired, their incomes no longer need to be tracked, and they may retain their low- or moderate-income status in counting the number of jobs created. Yet several local officials said that they were not allowed by their HUD field office to count individuals as low or moderate income if their incomes rose after they were employed either because of promotion or receiving a higher-paying job. In another example of inconsistent application of HUD's guidance, a Los Angeles job creation program that included job training as a component was cited by HUD as an exemplary program, while a similar program in Miami, Florida, was criticized by its HUD field office for using economic development funds for job training.

The problem of inconsistent guidance has been commonly acknowledged, and the Congress has directed HUD to address this issue. Specifically, in the Housing and Community Development Act of 1992, HUD was directed to use unexpended Urban Development Action Grant (UDAG) funds that it recaptures from grantees to provide continuing education and training to HUD officials responsible for monitoring and administering CDBG-funded economic development activities.[6]

The National Council for Urban Economic Development has recommended that this training include financial analysis of economic development activities within the context of a local community's needs and priorities. The Council believes that high-quality training on this topic targeted to a cadre of staff interested in economic development may provide consistency in how CDBG Program regulations are applied.

HUD headquarters officials said that they had begun some training of HUD's staff. In total, HUD had committed about $176,000 in recaptured UDAG funds to training as of September 30, 1993, $70,000 of which was spent specifically for underwriting training. HUD officials said they plan to spend more on training during fiscal year 1994 as funds become available. As of January 1994, HUD was readying courses on the fundamentals of economic development that officials estimated would start during the second quarter of fiscal year 1994. The officials noted that they will also have to train the staff on forthcoming new CDBG regulations required by the Housing and Community Development Act of 1992. As noted in chapter 1, these regulations are to consist of guidelines to assist grantees in selecting economic development projects for funding. HUD plans to issue proposed regulations for public comment in March 1994.

[6]The Urban Development Action Grant Program, administered by HUD, provided grants to help alleviate physical and economic deterioration in distressed cities and urban counties. Appropriations for the program were discontinued in 1989, but some unexpended grants remain.

Current Regulations on Income Level May Discourage Using CDBG Funds for Job Retention

Many communities have been hit hard by corporate downsizing and plant closures, making the retention of jobs a top priority. Yet current CDBG regulations may be counterproductive to that goal. Currently, these regulations are designed to ensure that the primary beneficiaries of the program are low- and moderate-income individuals and to permit the use of CDBG funds to save jobs only when a business is threatened with imminent closure or relocation. Some local officials have said these regulations make it difficult for their communities to use CDBG funds to assist struggling local businesses as a preventive measure—to forestall a situation in which the business is likely to move or close and thereby eliminate jobs.

Specifically, the CDBG Program allows program funds to be used for job retention only if it can be documented that the jobs would actually be lost without the assistance provided by the program. In addition, 51 percent of these threatened jobs either must be held by low- and moderate-income individuals or could reasonably be expected to become available to these people within the next 2 years. Documenting that a business will close is required if CDBG funds are to be used for job retention. However, documenting this situation is onerous, according to some local officials. Although HUD headquarters officials said that a public notice that the business is closing is not required as documentation, some local officials stated they will not use funds for job retention because they believe this is the only way to adequately document that the jobs will be lost. Local officials are reluctant to issue such public notices because they believe doing so puts an emotional strain on workers.

Other officials found it ironic that the CDBG Program rules make it difficult to save workers' jobs, although CDBG funds could be used to get them new jobs. They explained that the jobs saved might not meet the low- and moderate-income test. However, unemployed workers could qualify as low- and moderate-income persons and could then be counted towards the 51 percent requirement for job creation.

One official stated that in order to avoid the job retention requirements, his agency looks to see if any new jobs are created in the process of retaining jobs in a local firm. The agency then justifies the project on the basis of job creation rather than job retention. Another grantee said that his community uses other sources of funds for job retention activities because of the difficulty of complying with HUD's current regulations.

However, advocates for low-income people pointed out that without stringent regulations, firms could threaten to close simply to receive benefits from the CDBG Program that could have gone to benefit low- and moderate-income individuals. When asked how the regulations could be revised to both provide flexibility and safeguard the program from abuse, local officials and advocacy groups were not able to offer concrete suggestions.

The job retention issue was also raised by a HUD-sponsored CDBG paperwork reduction task force. In response to a task force recommendation, HUD is reevaluating requirements for job retention activities. In December 1992, HUD requested input from four national associations on issues relating to job retention and received what HUD officials characterized as limited input in January 1993. As of January 1994, HUD had proposed no regulatory changes. However, HUD officials did indicate that a change made by the Housing and Community Development Act of 1992 that allows the presumption of low- and moderate-income status in certain circumstances may make it easier for grantees to comply with the current requirements when using CDBG funds for job retention. (This change is discussed further in ch. 3.)

However, resolving grantees' job retention concerns while adequately safeguarding against program abuse is a difficult task. Other federal community development programs without the requirement to benefit low- and moderate-income people, such as SBA's 504 program, have had difficulty ensuring that companies are in real danger of closing rather than just trying to obtain government benefits. In determining when assistance is needed, HUD has the added responsibility of ensuring that the majority of benefits are for low- and moderate-income people.

The Davis-Bacon Act Imposes Administrative Burdens on Grantees

The Davis-Bacon Act was passed in 1931 during the Great Depression to ensure that federally funded government construction projects covered by the act would not be awarded to contractors whose bid was based on undercutting local wages. The act requires that contractors pay their workers the wage rates that prevail in the locality where the construction takes place. These wage rates are determined by surveys conducted by the Department of Labor. Pursuant to the statute establishing the CDBG program, the wages established under the Davis-Bacon Act apply to construction projects funded in whole or in part by CDBG grants. The same is not true, however, for certain other federal economic development programs, such as those administered by SBA.

While the Davis-Bacon Act seeks to protect local wage rates, there is controversy over its impact on the total cost of construction projects. Some studies have supported the complaints of CDBG grantees and others that the Davis-Bacon Act increases wages and drives up project costs. Other studies have concluded that the higher wages are offset by higher productivity and better quality work, leading to less rework and lower maintenance costs. In any case, documentation is required to show compliance with the law for all projects costing over $2,000.

The $2,000 threshold has remained unchanged for almost 60 years (since 1935). When adjusted for inflation, this would equate to about $21,000 in 1993. We found that some grantees, avoided the requirement to document compliance with the Davis-Bacon wage provisions by using CDBG funds on aspects of a project that do not involve construction and using other funds not subject to the act to finance construction. For example, we found one business loan in which CDBG funds were used for land acquisition while an SBA loan financed construction costs. Because SBA programs are not covered by the Davis-Bacon Act wage rates, the project avoided the CDBG documentation requirements.

We found agreement among the grantees we visited, economic development organizations, a housing group, and labor union representatives that the threshold should be raised, although there were disagreements about how high it should be. The September 1993 report of the President's National Performance Review task force recommended raising the threshold to $100,000.[7] The National Council for Urban Economic Development recommended that the Congress raise the threshold to $250,000. Similarly, the National Association of Housing and Redevelopment Officials recommended raising the threshold to $250,000 or applying the law to all projects in which federal funds account for more than one third of the project's financing. In contrast, the American Federation of Labor and Congress of Industrial Organizations supports raising the threshold to $15,000 for renovation and $100,000 for new construction.

Conclusions

CDBG funds targeted to economic development activities have been a relatively stable percentage of total CDBG funding. However, entitlement communities' economic development expenditures have declined in recent years in constant dollars. Although some grantees devote significant

[7]From Red Tape to Results: Creating a Government That Works Better & Costs Less, report of the National Performance Review, Vice President Al Gore (Washington, D.C.: Sept. 7, 1993).

amounts of their CDBG funds to economic development, others do not support economic development with CDBG funds. This wide range of use reflects several local variables, including the availability of other funding sources as well as the grantees' changing needs and priorities. Encouragement by the Congress or the administration is another external factor that also could influence the amount grantees choose to spend on economic development. For example, the Congress, through the Housing and Community Development Act of 1992, encouraged grantees to spend one percent of their annual grants on microenterprises.

Economic development officials believe that there are three primary restrictions to using CDBG funds for economic development. One restriction—confusion over the content and application of CDBG regulations—may be alleviated by economic development training that HUD recently began providing to its staff and plans to expand beginning in the second quarter of fiscal year 1994. HUD and others had been struggling to determine whether there is a suitable solution to the second restriction: a way to apply CDBG funds to job retention activities. Continuing these difficult efforts to find a solution is important because many economic development specialists view job retention as a critical economic development objective in today's economy. Finally, the $2,000 threshold for the Davis-Bacon Act, which is applicable to CDBG construction projects, imposes an administrative burden on grantees even for small projects. Some other federal economic assistance programs, such as those sponsored by the Small Business Administration, are not subject to this requirement. Numerous groups, including the Vice President's National Performance Review, agree that the threshold should be raised. However, raising the threshold is a legislative issue that affects more programs than just the CDBG Program.

Recommendations to the Secretary of HUD

We recommend that the Secretary assess the effectiveness of HUD's economic development training by obtaining periodic feedback from grantees and/or the organizations that represent them on HUD officials' consistency in interpreting CDBG program rules. In addition, the Secretary should ensure that CDBG program officials revive efforts to determine whether and how CDBG funds could be more easily used for job retention activities.

Issues Related to the Proper Use of Funds for Economic Development Activities

The primary goals of the CDBG Program are to develop viable communities, provide decent housing and a suitable living environment, and expand economic development opportunities, principally for people with low and moderate incomes. These goals provide the underlying criteria by which the proper use of funds for CDBG activities can be judged. A number of groups have questioned whether (1) CDBG-funded economic development activities have sufficiently benefited low- and moderate-income populations, (2) job creation meets the projected levels, (3) these activities provide unneeded assistance to for-profit businesses, and (4) CDBG-funded loans to for-profit businesses are properly safeguarded against loss.

Activities Should Principally Benefit Low- and Moderate-Income People

According to HUD's annual reports to the Congress, most CDBG economic development activities address the national objective of benefiting low- and moderate-income people. HUD says this objective is frequently met by creating or retaining permanent jobs, 51 percent of which either are or will be held by low- and moderate-income people or are considered to have been made available to such people. However, HUD's Inspector General, community groups, and others have questioned whether the benefits of CDBG economic development activities to low- and moderate-income people have been adequately documented. Changes mandated by the Housing and Community Development Act of 1992 should facilitate future documentation.

Documentation Requirements for Low- and Moderate-Income Job Creation and Retention

Before the Housing and Community Development Act of 1992, there were two ways a grantee could demonstrate that at least 51 percent of CDBG-funded jobs benefited low- and moderate-income people. The first way was to have the jobs actually taken by people meeting the area's low- and moderate-income standards. The relevant income was not that of the individual, but rather that of the entire household, similar to the criterion in federal housing assistance programs. Acceptable documentation could consist of a local form, signed by the employee, stating that his or her household income did not exceed the income standards for the relevant family size. (As an example, the 1993 income limits used by Buffalo, New York—an entitlement grantee—are shown in table 3.1.) No other documentation, such as copies of federal income tax forms, are required by HUD regulations, although some field offices may have imposed such requirements.

Table 3.1: Income Limits in Buffalo, New York, for Low- and Moderate-Income Households, as of April 1993

Number of people in household	Low-income limits	Moderate-income limits
1	$13,650	$21,850
2	15,600	24,950
3	17,550	28,100
4	19,500	31,200
5	21,050	33,700
6	22,600	36,200
7	24,200	38,700
8	25,750	41,200

The second way to comply with the low- and moderate-income test was to demonstrate that at least 51 percent of the jobs were made available to low- and moderate-income people. To do this, a grantee had to show that (1) the jobs did not require a skill level higher than a low- and moderate-income person would be likely to have[1] and (2) a sufficient number of low- and moderate-income people were interviewed for each position. HUD has applied the 51-percent low- and moderate-income test to the actual number of jobs created or retained, not to the number of jobs the grantee originally projected when applying for assistance.

Concerns About the Benefits of CDBG-Funded Jobs to Low- and Moderate-Income People

Audit reports by HUD's Inspector General as well as other studies have questioned grantees' compliance with the national objective of benefiting low- and moderate-income people. Most of these studies found that the benefits could not be demonstrated because of lack of documentation or that there was insufficient documentation that the benefits provided with CDBG funding were targeted to these populations.

In Seattle, Washington, for example, the Inspector General found almost no evidence that jobs were created or retained for low- and moderate-income people through CDBG economic development business loans.[2] Although HUD officials had previously brought this issue to the attention of city officials, the city had not corrected the situation at the time of the Inspector General's audit. As a result, neither HUD nor the grantee was sure, on the basis of documentation available at that time, whether $1 million in CDBG funds was used properly. (According to HUD

[1]The skill level can be higher if the employer is willing to train the employee.

[2]City of Seattle CDBG Entitlement Programs Special Economic Development Activities, Seattle, Washington, HUD's Office of Inspector General, 91-SE-241-1004, Sept. 20, 1991.

headquarters officials, the grantee later obtained adequate documentation for most of the expenditures.)

In another example, based on a 1992 multiregion audit,[3] HUD's Inspector General reported that 13 out of 19 grantees had no documentation or inadequate documentation to support the number of low- and moderate-income jobs reported as created or retained. Four businesses funded by two of the grantees were not even aware that such a job requirement existed.

Actual Jobs May Fall Short of Projections

HUD's Inspector General and community groups have expressed concern that the actual number of jobs for low- and moderate-income people resulting from CDBG-assisted businesses often fall short of projections. For example, the Inspector General's 1992 multiregion audit found that half of almost 3,500 jobs projected when the grantees decided to fund economic development activities had not been created at the time of the audit.

The extent to which this occurs overall is not known. Although HUD requires grantees to report projected and actual jobs created or maintained, HUD officials said they have not done any overall analysis of this information to determine the extent to which actual jobs fall short of projections.

Recent Legislation Should Facilitate Documentation of Low- and Moderate-Income Benefit

The Housing and Community Development Act of 1992 allows grantees to use additional processes to document job benefits to low- and moderate-income people. As a result of these changes, an employee is presumed to have low- or moderate-income if one or more of the following conditions apply:

- The employee resides in, or the assisted activity through which he or she is employed is located in, a census tract that meets the eligibility criteria for a federal enterprise zone;[4] or
- the employee resides in a census tract where not less than 70 percent of the residents have incomes at or below 80 percent of the area's median income.

[3]Multi-Region Audit: Special Economic Development Activities, HUD's Office of Inspector General, 92-TS-145-0009, Apr. 29, 1992.

[4]HUD officials said that the term "enterprise zone" is comparable to the term "empowerment zone" used in subsequent legislation.

These changes are similar to those recommended in the February 1991 report of the HUD-sponsored paperwork reduction task force. The task force's recommendations were intended to reduce burdensome documentation requirements. HUD and others took exception to the task force's recommendation of using the businesses' location as a method of documenting low- and moderate-income status. HUD's CDBG officials maintained that it is unreasonable to assume that people who work in a low- and moderate-income census tract are low- and moderate-income people. Also, the minority view of the paperwork reduction task force emphasized that the use of census tract data as a presumption of low- and moderate-income status could allow people whose income is not low to benefit, in certain circumstances.

Although it is too early to know what effect these changes will have, they should, in some cases, make it easier for grantees to document the benefit to low- and moderate-income people of economic development activities. As stated above, such documentation was previously a significant area of noncompliance.

Economic Development Activities Must Meet an Appropriateness Test

In many communities, the competition among activities for limited CDBG funds can be intense. Grantees providing assistance to for-profit businesses are required to meet an appropriateness test, which, among other things, ensures that the amount of assistance is not excessive relative to the actual needs of the business and the extent of expected public benefit. HUD's Inspector General has also questioned compliance with this requirement, and the issue of appropriateness was the subject of changes in the Housing and Community Development Act of 1992. The act required HUD to issue guidelines to assist grantees in evaluating and selecting which economic development activities should receive CDBG assistance. HUD officials indicated that these guidelines, which the act says must be in the form of regulations, should be issued for public comment in March 1994.

Determining That Assistance Met the Appropriateness Test

The appropriateness test seeks to ensure that a for-profit business is not unduly enriched by the CDBG assistance it receives. The test used during our audit work was based on the CDBG legislation, as amended in 1990.[5]

[5]The law originally required that the CDBG assistance be "necessary or appropriate." The Cranston-Gonzalez National Affordable Housing Act of 1990 deleted the words "necessary or." However, HUD does not believe this change altered the review grantees must perform. Nor was this statutory change addressed in any subsequent HUD regulation.

HUD's guidance to its offices has emphasized that before providing financial assistance to for-profit businesses, grantees must determine and document that the assistance is "appropriate."

HUD's March 1992 guidance recommended that to meet the appropriateness requirement, grantees determine that there is a need for the financial assistance. HUD also recommended that grantees ascertain that the CDBG funds would allow a business a reasonable return on its equity investment, consistent with industry standards for that type of business. According to HUD, CDBG assistance may not be appropriate if (1) it exceeds the business's needs and the expected public benefit, (2) it substitutes for available private debt financing, or (3) the assisted project is not likely to succeed.

Concerns About Grantees' Compliance With the Appropriateness Test

HUD's Inspector General has questioned grantees' compliance with the determination of appropriateness. In the previously cited multiregion review, HUD's Inspector General found that 13 of the 19 grantees reviewed did not adequately perform or document the required analyses to determine that the CDBG assistance was necessary or appropriate. It further pointed out that 2 of the 13 grantees failed to do any analysis.

Individual audits of local grantees have found similar instances of poor documentation. For example, in an audit conducted in 1992, HUD's Inspector General found that Kenosha, Wisconsin, did not document the appropriateness test and did not adequately support the amount of loan assistance given or the public benefit derived from the loans the grantee approved. In a 1992 audit, HUD's Inspector General found that Memphis, Tennessee, did not have adequate documentation to support the eligibility of 22 economic development loans totaling $2.7 million.

Some of the HUD Inspector General's findings were discussed in oversight hearings held in October 1991 and March 1992 by the Employment and Housing Subcommittee of the House Committee on Government Operations. One case discussed was a $5 million interest-free loan to a major national retailer for which HUD's Inspector General had questioned both the need and the amount.[6]

[6]The retailer voluntarily repaid the loan after the Inspector General's regional audit report was published.

Future HUD Guidelines May Assist Grantees in Determining When to Assist CDBG Economic Development Activities

Compliance with the appropriateness test may be affected by changes mandated by the Housing and Community Development Act of 1992. The act requires HUD to establish, by regulation, guidelines that could be used by grantees to evaluate and select economic development activities to be assisted with CDBG funds. The guidelines are to cover certain project cost and financial requirements. The guidelines are also to address the public benefit that is to be derived from the CDBG funds provided.

HUD indicated that the act's purpose for establishing these guidelines by regulation was to ensure that grantees have the opportunity to review and comment on the guidelines before they take effect. HUD officials estimate that the guidelines should be published for comment by March 1994. Until these guidelines take effect, grantees are to follow the guidance last provided by HUD on March 6, 1992.

The 1992 act established the following objectives for CDBG economic development activities that HUD must address in the new guidelines:

- The costs of the projects should be reasonable.
- To the extent practicable, reasonable financial support should be committed for such activities by nonfederal sources before federal funds are disbursed.
- To the extent practicable, any grant amounts provided for such activities should not substantially reduce the amount of nonfederal financial support for the activity.
- Such activities should be financially feasible.
- To the extent practicable, such activities should provide not more than a reasonable return on investment to the owner.
- To the extent practicable, grant amounts used for the cost of such activities should be disbursed on a pro rata basis with amounts from other sources.

The act indicates that in auditing grantees, HUD cannot use a failure to achieve one or more of the above objectives as a basis for ruling that a project was not eligible for CDBG funding. Therefore, it is possible that a project could fail to comply with all of the above guidelines and still be eligible for funding.

The 1992 act also requires that public benefits provided by economic development activities be appropriate relative to the amount of CDBG assistance provided. However, HUD can rule on project eligibility based on compliance with the guidelines that it develops for this requirement, unlike the case for the cost and financing objectives discussed above.

CDBG Should Be Safeguarded Against Unnecessary Losses

CDBG-funded economic development activities often consist of loans to for-profit businesses that the recipient must repay to the grantee. Concerns have been raised by a congressional committee and HUD's Inspector General about whether grantees are properly safeguarding these loans.

Loan defaults may occur when businesses are unable to make the required payments. Although the business may continue to operate, some or all of the loaned money may be lost, and the default may also result in loss of the activity's benefits, such as additional jobs and increased taxes. As we will discuss in chapter 5, there is no established acceptable default rate for CDBG economic assistance loans. However, given that such loans are usually made to businesses that cannot obtain sufficient private financing, a higher than normal default rate might be expected. HUD officials added that many of these loans are made to small businesses located in distressed areas that have high crime rates and lack adequate public services.

Defaults on CDBG loans has been persistently identified as a problem by HUD's Inspector General. In April 1992, the Inspector General recommended that HUD establish standards for measuring the status of loan failure rates. However, as of January 1994, no standards had been issued.

HUD's Inspector General has found many instances of for-profit businesses in default or delinquent on CDBG loans. In the 1992 multiregion review, the Inspector General found that 43 percent of the loans originated by 19 grantees reviewed were either in default or delinquent. The report also stated that the poor management practices of these grantees put over $10 million at risk of loss. Another audit found that Memphis, Tennessee, had approved 18 loans totaling $7.3 million; 16 of these loans defaulted because the businesses failed. As a result, the grantee lost $6.3 million.

Grantees' use of the Section 108 Loan Guarantee Program can place even more CDBG funds at risk because of the larger dollar amounts of many of the Section 108 loans.[7] Audits by HUD's Inspector General have identified

[7]This premise assumes that grantees' use of Section 108 loan guarantees increases the grantees' level of funding for economic development.

instances in which these larger loans were made for unsound projects. Tacoma, Washington, for example, loaned almost $500,000 in Section 108 funds to a developer who used the money for other than the stated purpose, never completed the project, and defaulted on the loan. The grantee thus had to pay the $500,000. A similar large default by a developer in Niagara Falls, New York, also resulted in the grantee's incurring a loss.

In some cases, a community may correctly analyze the risk of a loan but still determine that its best interests are served by underwriting it. This was the case with a Section 108 loan earmarked for a steel corporation that was a major employer in Pennsylvania. In reviewing the application, the HUD field office economist characterized the loan as very risky because it would not ensure the company's continued operations. Nevertheless, the HUD economist agreed that the community had little choice because the company was the area's primary employer. In short, the HUD economist agreed that the anticipated benefit, though not guaranteed, might be worth the high risk assumed.[8]

As HUD's Inspector General recommended, HUD will be establishing a data base to record loan defaults and delinquencies for CDBG Entitlement Program funds and has begun requiring grantees to report this information as part of their latest grantee performance report.[9] An understanding of loan defaults and delinquencies is especially important in light of changes in the National Affordable Housing Act of 1990 that expanded the Section 108 Loan Guarantee Program and HUD's current promotion of the use of Section 108 CDBG funds. Future defaults on these larger Section 108 loans could substantially affect the grantees' abilities to fund future CDBG activities, such as housing and public services.

Conclusions

Proper use of funds for economic development activities is essential if the overall objective of the CDBG Program—to expand economic opportunities for low- and moderate-income people—is to be achieved. Previous findings by HUD's Inspector General have identified areas in which grantees needed to improve documentation of compliance with existing CDBG regulations. Although it is too early to determine the effect, regulatory changes mandated by the Housing and Community Development Act of 1992 may result in a higher level of compliance by making it easier for grantees to document benefits to low- and

[8]The grantee did not make the loan because the company went bankrupt.

[9]As of January 1994, HUD was also examining the failure rate of a judgmentally selected sample of 1988 economic development projects in the State-Administered Program.

moderate-income populations and by assisting grantees in their selection of activities to be funded. However, HUD and others are concerned that documenting benefits to low- and moderate-income people based solely on the location of an assisted business may result in an overstatement of such benefits.

Delinquencies and defaults on loans that CDBG grantees make to for-profit businesses have been another area of concern to HUD's Inspector General. As the Inspector General recommended, HUD now requires grantees to report delinquencies and defaults on these loans and is establishing a system to record this information. In time, this system should provide national information on grantees' experiences that grantees would find useful in assessing the performance of their own loan portfolios. These national data should also be useful to HUD and to the Congress in assessing the seriousness of the loan delinquency and default situation. Should the data show that there is a serious problem, further analysis of these data might also help determine the causes.

Recommendation to the Secretary of HUD

The Secretary should include in HUD's annual report to the Congress on the CDBG Program the data that HUD is starting to collect on delinquencies and defaults on economic development loans that grantees make to for-profit business.

Types and Quality of CDBG-Funded Jobs

No requirements govern the specific types of jobs that can be funded through CDBG, and little information is available on the jobs that have been funded. As noted in chapter 2, grantees have considerable discretion in funding a wide range of businesses. The limited data available suggest that grantees have funded a wide variety of jobs earmarked for low- and moderate-income people. Judging the quality of these jobs would require both an accepted definition of quality and detailed data on the jobs' characteristics, such as pay, benefits, and opportunities for advancement. However, neither of these elements is currently available.

Certain circumstances mitigate against attempting to establish a national quality standard for the jobs that CDBG grantees fund for low- and moderate-income people. To some extent, national economic conditions, such as employment trends, affect the types of jobs being created. Also, local factors, including local economic conditions and the community's economic development strategies, affect perceptions of quality and the types of jobs that can be funded. Nevertheless, setting expectations for job quality and encouraging the funding of such jobs at the local level is a desirable goal that some grantees are already pursuing.[1]

HUD Has Limited Data on the Types or Quality of CDBG-Funded Jobs

Activities that qualify for CDBG funds on the basis of the jobs they will create or retain are not required to provide jobs with a certain wage, specified level of benefits, or potential for advancement. The principal requirement is that 51 percent of the jobs created or retained must be either taken by or made available to low- and moderate-income people. HUD does not systematically collect data on the types of jobs created or retained. Nor has it done any formal analysis of jobs created by the CDBG Program to ascertain their characteristics.

For each job creation or retention activity, grantees are required to maintain records of the titles of the permanent jobs filled by or made available to low- and moderate-income people. Entitlement grantees are required to attach a narrative describing the titles of the jobs made available to low- and moderate-income people to their annual GPRs. (The titles of jobs actually filled by low- and moderate-income people do not have to be identified.) These narratives rarely contain any data on job characteristics, such as pay rate or benefits.[2] However, HUD officials said

[1]As noted in chapter 1, it is difficult to estimate the net effect the CDBG program has on either job creation or job quality because some of the same employment decisions may have occurred in the absence of CDBG funding.

[2]States are not required to include this information in their annual PERs.

that some limited data on pay levels will be gathered in a HUD-funded study of the Entitlement Program being conducted by the Urban Institute.

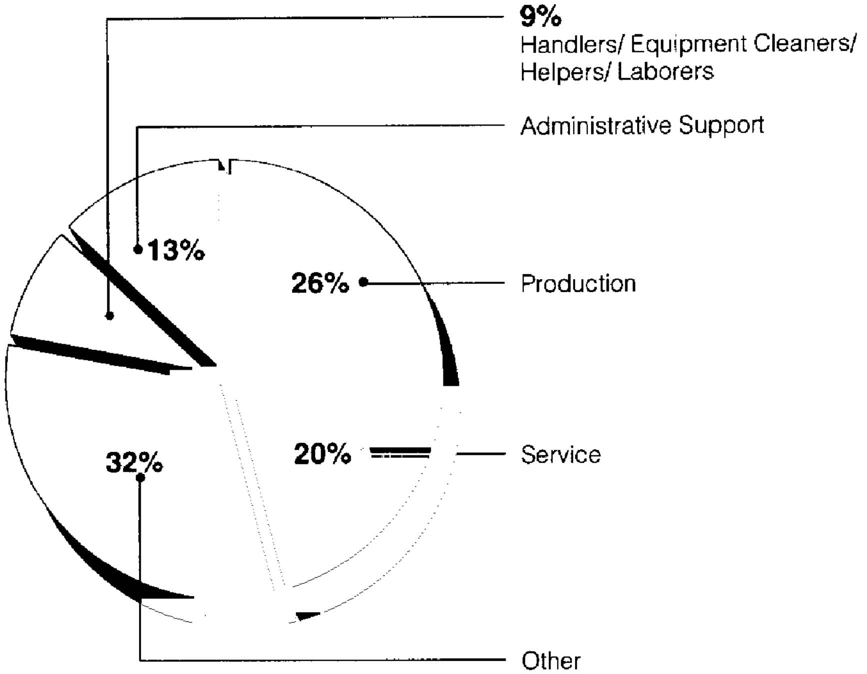
Limited Available Data Suggest Grantees Have Funded Many Types of Jobs for Low- and Moderate-Income People

In a review of selected GPRs from fiscal year 1990, we found that the types and likely salaries and advancement potential for CDBG-funded jobs varied widely.[3] Reported jobs were distributed among many different occupations, which have a wide spectrum of pay rates and potential for advancement, according to Department of Labor occupational guides.

We used the Bureau of Labor Statistics' (BLS) Occupational Outlook Handbook to categorize the job types reported in the GPRs. This publication classifies jobs into 12 major civilian occupational categories. Jobs reported as available to low- and moderate-income people in the 1990 GPRs fell primarily into four of these categories. (See fig. 4.1).

[3]Although these jobs are not necessarily representative, they provide an overview of the type of jobs that grantees are funding. Of the 343 GPRs that reported activities justified on the basis of jobs, we reviewed the 81 GPRs that contained a narrative on the job types.

Figure 4.1: Types of Jobs Funded by Grantees



The 12 major civilian occupational classifications are each composed of a wide range of more specific positions, with a correspondingly wide range of salaries and potentials for advancement. For example, the administrative support occupations category consists of 16 positions, such as general office clerks, hotel clerks, messengers, secretaries, bookkeepers, and word processors.

Some grantees and experts associate lower quality characteristics with the types of jobs created for low- and moderate-income people using CDBG funds. For example, although CDBG-funded hotel projects can create administrative support, service, executive, and managerial jobs, hotel positions available to low- and moderate-income people are often the lower-quality service jobs like housekeeping and janitorial work.

Neither a Definition Nor Data Sources Exist to Determine Job Quality

The federal government has not defined what a quality job is, nor is there a generally accepted definition. Without an accepted definition of job quality, there is no objective way to determine whether the jobs funded are quality jobs. In addition, even if such a definition existed, data would have to be collected on job characteristics, such as pay rate, benefits, and job progression, to determine whether a job actually met the defined quality components. Currently, data on such job characteristics are not widely available for CDBG-funded jobs.

There Is No Standard Definition of Job Quality

According to labor experts, including officials from the Department of Labor and the Congressional Research Service, there is no federal definition of job quality. However, these officials said that potential broad indicators of quality may include (1) the level of pay; (2) the promotion and pay potential; (3) the availability of benefits like health insurance; (4) the availability of training to enhance work skills; (5) the job duration (all year versus seasonal); (6) the workweek length (full-time versus part-time); (7) the working conditions, including a safe working environment; and (8) access to the place of employment.

If such broad indicators are to be useful in promoting job quality, appropriate indicators would have to be selected and specific desired criteria established for each. For example, a desired pay criterion might be a rate that is a certain level above the minimum wage or a certain percentage of the average local pay rate. Similar refinements could be developed for other potential quality indicators. However, the grantees themselves are probably best suited to perform this task because, as discussed later in this chapter, a number of local variables can shape a community's perception of job quality and its ability to fund higher-quality jobs through the CDBG Program.

Longitudinal Data Are Not Collected to Determine Long-Term Job Quality Factors

Setting an acceptable definition is just one element in determining whether jobs are quality jobs. Because potential indicators, such as promotion, pay progression, and job training, span a period of time, data need to be gathered from the employer on whether such events have occurred. Collecting such data could impose a costly regulatory burden on both the grantee and the assisted business if the information is not already being compiled. Yet without such data, it may be difficult for grantees to demonstrate that the low- and moderate-income employees hired ever obtained a quality job.

Currently, HUD does not require grantees to collect data on characteristics, such as pay rates, benefits, and opportunities for advancement, for low- and moderate-income jobs. HUD officials indicated that such information is rarely maintained by grantees, primarily because of the paperwork burden. Grantees told us that adding additional CDBG requirements would make the program far less appealing to businesses and reduce its usefulness as a vehicle for economic development. Also, requiring such documentation may clash with previously discussed changes mandated in the Housing and Community Development Act of 1992, which may reduce the documentation certain CDBG-assisted businesses must provide.

In lieu of collecting actual data on the quality of CDBG-funded jobs, job quality could be estimated using the Department of Labor's Occupational Outlook analysis. However, Labor's analysis is not employee specific and generalizes such factors as pay and potential for advancement. For example, opportunities for advancement for hotel clerks, as described by Labor's 1992-93 Occupational Outlook Handbook, will depend on additional training and/or education. A full-time clerk may have median weekly earnings of $230, but this figure may vary significantly depending on the location, type, and size of the hotel. For example, hotels in metropolitan areas pay clerks more than those in other locations.

A 1990 study of the State-Administered Program conducted by the Council of State Community Development Agencies looked at several elements that could be associated with job quality. The study found that about 70 percent of jobs funded by CDBG in these small, predominately rural communities paid less than $300 per week, while more than 50 percent of U.S. workers earned over $373 per week. However, the study also found that 96 percent of the jobs created offered year-round employment and that almost 20 percent of the workers hired under the CDBG Program were subsequently promoted.

Local Perceptions and Targeted Populations Affect the Definition of Acceptable Job Quality

The local economic conditions and employment base often affect how a quality job is defined. For example, HUD officials and many others have indicated that almost any job in some locations of high unemployment may be viewed positively. In some economies, there may be a shortage of employees with skills in a particular field. Therefore, an entry-level job in that field may be considered a quality job. The circumstance at a firm in Michigan, where the economy is getting stronger, illustrates this point. At this furniture manufacturer, individuals are often hired with no skills and apprenticed in skilled positions. Because a number of furniture manufacturers in the area require these skills, the firm was reluctant to lay anyone off, even temporarily, because that person would be immediately hired by a competitor.

According to many grantees, the people targeted by the CDBG Program often have no work experience, so the goal is to introduce them to the work environment. These first-time jobs are often low-paid, low-skill retail or service jobs. However, the National Community Development Association argues that such jobs often provide people with experience in full-time, long-term employment. Getting these people into a first job improves their future productive capacity and earning potential.

For example, a battery manufacturer in Michigan provides employment to individuals referred to the company through the local Job Training Partnership Act organization. Many of these individuals have very poor math skills, and some are mentally impaired. The company offers remedial math classes for all its employees and promotes individuals who are successful on the production line.

Various Conditions Affect Grantees' Ability to Fund Quality Jobs

Various economic factors, both national and local, affect grantees' ability to fund economic development activities that produce quality jobs. These factors include national employment trends, the practices of the firms assisted, and economic development strategies that are particular to the local geographic area.

The national employment trend is toward growth in the service industry, in which many positions do not pay high wages. According to Labor's 1992-93 Occupational Outlook Handbook, the service industry—which includes a wide range of jobs in the protective services, food and beverage preparation, health services, cleaning, and other personal services—is expected to grow faster than other industries. Many of these jobs pay at or just above the minimum wage.

The quality of the local work force may also influence the ability of grantees to create quality jobs. For example, in Shandaken, New York—an area facing high unemployment—there is a need to provide jobs for low- and moderate-income residents with limited job skills. One-third of these residents have not completed high school. Therefore, the local strategy is to fund economic development activities that create jobs that do not require extensive training or education.

A CDBG grantee's emphasis on providing financing to smaller businesses may also affect whether the grantee can provide jobs with good fringe benefits. In a June 1993 survey of small and mid-sized businesses, the Arthur Andersen Enterprise Group reported that the size of the business affects employee benefits: Smaller firms are less likely to provide such benefits. The study reported that 54 percent of firms with fewer than 20 employees offered health and medical insurance, while 99 percent of businesses with 100 or more employees did so. The study also indicated that only 9 percent of the firms with fewer than 20 employees provided tuition reimbursement, compared with 55 percent of those firms with 100 or more employees.

CDBG grantees face a diverse range of economic conditions requiring flexible economic development strategies to meet local needs. The economic strategies of grantees in areas with high unemployment may differ from the strategies of grantees in areas that have low unemployment rates. Also, other factors may take precedence over the quality of the job created. For example, assisting a grocery store that operates in an underserved inner-city neighborhood may be of considerable benefit to low- and moderate-income residents, yet it may result in mostly minimum-wage jobs. Similar arguments could be made for other retail establishments, such as department stores. Economic development officials in Buffalo, New York, indicated that as part of their downtown revitalization strategy, they were attempting to attract a department store to fill a retail gap created when a department store previously located in the area closed. Such a store may create mainly low-paying clerk positions yet contribute significantly to Buffalo's revitalization efforts.

Also, some assisted businesses may be unable to afford to offer benefits. As discussed in chapter 5, many companies qualifying for loans under the CDBG Program are not as strong financially as other entities in the marketplace. If they were, they could qualify for 100-percent conventional financing.[4] Requiring these businesses to provide extra benefits would not only be costly but may make their labor costs more expensive than those of their competitors who are not funded by CDBG. Increased labor costs would adversely affect their chances for success. Indeed, the added cost might affect their projected cash flow so much that they would no longer be a viable project able to qualify for funding.

[4]This point is vividly made in the slogan for the Southern Dallas Development Corporation (SDDC), the organization that Dallas contracts with to provide CDBG business loans: "SDDC is a place to go when the bank says no."

Grantees Can Promote Quality Jobs in CDBG Projects

Despite the potential difficulties, many grantees have developed strategies to encourage the funding of CDBG projects that promote quality jobs. Within the framework of the CDBG Program, they choose projects that are likely to result in quality jobs. In our review of fiscal year 1992 program documentation[5] for the State-Administered Program, we found that 18 states give additional weight to projects offering competitive wages, fringe benefits, training opportunities, or the potential for advancement. For example, in determining which projects to fund, New Hampshire provides additional points for projects offering competitive wages and benefits, full-time hours, nonseasonal jobs, and job training. Likewise, both Florida and Massachusetts give preference to projects that offer higher wages and benefits. New Jersey, in its evaluation of proposed projects, considers the potential for career development and advancement as well as the training opportunities provided.

Communities in the Entitlement Program have the same flexibility to promote job quality if they desire. For example, a local official administering the CDBG Program through an economic development corporation in Portland, Oregon, categorized that city as having a healthy and growing economy. The official added that, at a minimum, any projects funded must pay $6.50 per hour—150 percent above minimum wage—and offer health benefits.

We also found examples of individual CDBG-funded businesses that emphasized various job quality characteristics at the four sites we visited. The owner of a distribution business in southern Dallas stressed formal education. The owner expected employees to attend school and paid 100 percent of the costs, provided the majority of the courses were on business subjects. In addition, this owner paid employees an average of $23,500 annually. A cabinet manufacturing company located not far from the Dallas downtown area offered its employees a complete occupational benefit package. Management believed that in order to improve production, the company had to offer its workers certain incentives. Therefore, in addition to providing health and life insurance and paid holidays, the company was also studying the possibility of assisting the workers in obtaining their own homes in the area.

In Michigan, we visited two manufacturing firms that had received CDBG loans. Starting salaries for entry level jobs at both were between $5 and $7 per hour, and employees could not only earn salary increases but also

[5]States are required to submit annually to HUD a statement outlining their CDBG program objectives and method of funding distribution. In their annual final statements outlining their program objectives, states may include their criteria for deciding which CDBG jobs to fund.

move to positions with increased responsibility. These two firms offered medical insurance as well as some additional benefits, such as life insurance, dental insurance, and retirement plans.

Giving priority for CDBG funding to firms that pay a decent wage or allow for upward mobility has been recommended by several national low-income economic development organizations. These include the Center for Community Change, the National Council for Urban Economic Development, and the National Economic Development Law Center. Other national organizations, such as the National Community Development Association, while supportive of the goal of creating higher quality jobs with CDBG funds, argue that doing so might conflict with the grantees' ability to principally benefit low- and moderate-income people.

Conclusions

The limited data available suggest that there is no typical CDBG-funded job. Job types vary in part by the type of business assisted. Determining whether the jobs funded are quality jobs will require both criteria on what constitutes quality and more detailed data on the characteristics of the jobs. Neither element is currently available. However, there are potential indicators that, with refinement, may be useful in helping to define job quality characteristics.

We believe that setting job quality criteria and expectations is a task best left to the individual grantees. Numerous local variables can affect grantees' job needs, perceptions of quality, and ability to fund jobs meeting a certain definition of quality. Mandating any standard job quality measurements that CDBG-funded jobs must meet may also (1) significantly reduce the flexibility of the grantees to carry out their local economic development initiatives and (2) result in another regulatory burden if such quality measurements need to be documented or monitored by the grantees.

Nevertheless, we believe the creation or retention of quality jobs is a desirable goal that should be encouraged. The CDBG Program currently allows grantees the flexibility to consider job quality in their funding decisions, and some grantees already give preference to projects that provide desired jobs quality elements.

Recommendation to the Secretary of HUD

The Secretary should instruct HUD's CDBG program managers to encourage grantees to establish and apply goals for job quality through means such as distributing to them information on useful criteria that other grantees have developed and used.

Numerous Measurements May Be Used to Gauge the Effectiveness of Economic Development Under CDBG

While the CDBG Program can stimulate economic development within communities, without a comprehensive set of accepted performance measurements, it is difficult to evaluate how effective these activities are. Numerous performance measurements could be used by CDBG grantees to evaluate the effectiveness of their economic development initiatives.

Regardless of what measurements are used, they need to be applied in the context of local economic conditions and conform with the overall objective of the CDBG Program to principally benefit low- and moderate-income people. Key indicators of effectiveness could measure one or more of the following outcomes: (1) the number, cost, targeted population and type of jobs funded; (2) the increases in the community's tax base; (3) the leveraging of public and private funds relative to the CDBG investment; (4) the level of loan defaults; (5) the creation of needed essential services and facilities; and (6) the types and sizes of businesses assisted. In addition, indicators could attempt to measure CDBG's contribution to an overall effort to revitalize a neighborhood. However, doing so would likely be difficult and costly.

As previously noted, measuring the results of local CDBG programs is difficult because some of the results attributed to CDBG funding of economic development activities may have occurred anyway. In the absence of a control group or some other suitable methodology, it is difficult to accurately estimate what results would have occurred without the CDBG funding. This limitation needs to be kept in mind in this discussion on performance measurements.

In response to the Housing and Community Development Act of 1992, HUD is developing guidelines to assist grant recipients in evaluating economic development activities assisted with CDBG funds. HUD officials indicated that these guidelines should be issued for public comment in March 1994. To some degree, these guidelines may assist grantees in establishing their own performance measurements.

Measurements Should Reflect the Nature of the CDBG Program

Regardless of what performance measurements are used, it is important that they recognize the nature of the CDBG Program. As a block grant program, it is intended to be flexible and allow grantees to match CDBG resources to their individual needs. Furthermore, performance measurements should reflect the overall goal of the CDBG Program, which is principally to benefit low-and moderate-income people.

According to grantees, federal officials, and economic development experts, the flexibility of the CDBG Program is its greatest strength. They acknowledge that given the variety of local circumstances and conditions, it would be difficult to choose a standard set of measurements that would apply to all grantees.[1] Instead, grantees could measure the outcomes of their economic development activities against their own local economic development goals.

Furthermore, because the program's mission is to benefit low- and moderate-income people, performance measurements must be based on considerations other than measurements of economic development in general. For example, default rates—a common measurement for other economic development programs—may be expected to be higher for CDBG loans, since they are targeted to higher risk businesses that are often located in distressed areas. However, they should not be so high as to imprudently waste limited funds to the detriment of all community residents, including the low- and moderate-income residents.

The Housing and Community Development Act of 1992 requires HUD to issue guidelines to assist grantees in evaluating the public benefit of CDBG-funded economic development activities. These guidelines, which may address such factors as the types and characteristics of CDBG-funded jobs, may assist grantees in measuring some elements of program effectiveness. According to HUD officials, the guidelines are being drafted and should be issued for public comment in March 1994.

Jobs as a Performance Measurement

Indicators related to jobs are frequently used to measure the effectiveness of economic development initiatives. The number of jobs funded, the cost per funded job, the targeted population hired, and the type of job created or retained can all be used to measure effectiveness. In varying degrees, these measurements are currently being used by CDBG grantees.

Number of Jobs

Currently, CDBG grantees are required to document the total number of jobs created or retained as a result of CDBG-funded activities that are justified on the basis of job creation. Although HUD does not require that a specific number of jobs be created, grantees often use this as a criterion in their decisions about funding projects or businesses. Grantees may waive

[1]The need to account for individual local circumstances was recognized by HUD in its current evaluation of the impacts of the CDBG Entitlement Program. In this evaluation, being conducted by the Urban Institute, local urban development experts are helping assess the impact of the program in each of the locations studied.

certain program requirements if the number of jobs created surpasses a certain amount. For example, in Missouri, if a new or expanding company creates more than 1,500 jobs, the maximum grant award can be raised from $400,000 to $2 million.

Cost Per Job

Although HUD does not prescribe any limits on the total cost per CDBG-funded job, we found that some grantees use maximum-cost-per-job funding criteria, ranging from $2,000 to $50,000 depending on the local conditions and type of economic development activity funded. This ratio could be based on either the total investment or the CDBG investment per job. For example, Nebraska imposes a maximum cost of $20,000 in CDBG funds per job created or retained. HUD officials also pointed out that the cost per job may vary depending on the industry assisted.

Unlike CDBG, some federal economic development programs attach a maximum dollar amount to jobs funded. For example, in SBA's 504 program, which provides long-term financing to small businesses, the amount of SBA loan per job created cannot exceed $35,000.

Targeted Population

Potential performance measurements also include the percent of jobs that benefit a specific population, such as low- and moderate-income people. As discussed previously, CDBG rules require that at least 51 percent of jobs created be either taken by or made available to low- and moderate-income people. However, grantees can and have set higher standards. For example, Wisconsin's State-Administered Program requires that at least 70 percent of all CDBG-funded jobs be filled by low- and moderate-income people. Louisiana requires that at least 60 percent of CDBG-funded jobs be made available to low- and moderate-income people.

Another job-related indicator could be the extent to which a specific target group of low- and moderate-income people benefited. One such measurement could be how many CDBG-funded jobs were taken by clients of various local job training programs, such as those funded by the Job Training Partnership Act or HUD's Family Self-Sufficiency Program.[2] This measurement could be further stratified. For example, the National

[2]The Job Training Partnership Act authorized the primary federal employment and job training programs, which provide employment and job training to economically disadvantaged and dislocated workers requiring retraining. HUD's Family Self-Sufficiency Program provides services to enable a family to achieve economic independence and self-sufficiency. Each housing authority that receives additional rental assistance funding, unless granted a waiver, must operate a Family Self-Sufficiency Program.

Economic Development and Law Center has suggested that in pursuing job strategies, jobs could be targeted to the (1) working poor, (2) unemployed, (3) persistently unemployed, (4) dependent poor, and (5) indigent.

Type of Job

Other job-related performance indicators could measure the type and quality of the job created or retained, which would require assigning desirability factors to define the quality of the jobs. For example, many state grantees emphasize manufacturing industries because jobs in these industries are often associated with higher wages. At the same time, some state grantees either discourage or disallow funding for retail and service positions because they are often considered low-wage, low-quality jobs. Also, Nebraska's State-Administered Program specifically states that it will not fund retail businesses. The difficulty of measuring the quality of CDBG-funded jobs and the need to tailor measurement indicators to local priorities was addressed in chapter 4.

Tax Revenues as a Performance Measurement

An increase to the local tax base resulting from assistance to a business, such as increased property and sales taxes, may take time to materialize but is a potentially measurable performance indicator. This indicator could also include additional local income taxes paid by the newly hired employees—employees who previously may have been unemployed or receiving public assistance. Increasing or maintaining the local tax base enhances the ability of a community to provide essential services.

As noted in chapter 1, measuring whether or how CDBG can affect tax revenues could be difficult. However, it may be possible. Increases in tax revenues were considered in the past in the UDAG program. In selecting projects to receive UDAG awards, HUD considered the amount of tax revenues to be generated from these projects.

Several grantees in CDBG's State-Administered Program indicated that they currently consider the anticipated increase to the local tax base when evaluating potential CDBG investments. For example, in Missouri's program, CDBG-funded infrastructure projects should generate new tax revenues at a level more than triple the CDBG assistance within a 5-year period. New Jersey's program gives funding preference to the economic development projects that will create or maintain tax revenues with the least amount of CDBG funds.

Enhancement of the tax base can also ease the tax burden on low- and moderate-income residents. For example, in Shandaken, New York, tax rates are high in relation to average income. This puts a significant burden on low- and moderate-income families, who must pay a disproportionate share of their income in real estate taxes. Therefore, this small town plans to use CDBG funds to support economic development that will increase its tax revenues.

Other grantees with significantly declining local economies stress the need to simply maintain their tax base. Such may be the case in communities experiencing corporate and defense industry downsizing and reductions. For example, Maryland's State-Administered Program gives priority consideration to projects that maintain the existing tax base by diversifying the local economy.

Leveraging as a Performance Measurement

In the current tight fiscal climate, with limited federal, state, and local dollars available to meet local community needs, communities need to stretch their public funds as far as possible. Therefore, an important potential performance measurement could be how effectively grantees can leverage their scarce public resources. CDBG economic development funds have been used as a stimulus to generate other financing for projects that could not have been undertaken otherwise.

CDBG funds are typically funneled through quasi-public economic development corporations that package public and private sources of funds together to make a project feasible. The percentage of private funds invested in a project relative to the CDBG and other public funds invested can be a measurable performance indicator.

Some grantees are already applying this indicator. For example, Tennessee requires that start-up firms have a 20 percent equity stake and that 30 percent of the project's financing come from private sources. Michigan requires at least a 3 to 1 leverage ratio of non-CDBG public and private dollars to CDBG funds. A battery manufacturer in Muskegon County, Michigan, received a CDBG working capital loan of about $500,000, which leveraged an additional $2.5 million—a ratio of 5 to 1.

The CDBG Section 108 Loan Guarantee Program is another facet of the CDBG Program that, under the current administration, is receiving additional emphasis. The Section 108 program guarantees funding for larger, more costly projects. This program can maximize the leveraging of private resources without the investment of CDBG funds.[3]

Other federal loan programs, such as those administered by SBA, already have performance thresholds that CDBG grantees might consider. SBA's 504 loan program requires that for every two dollars that SBA guarantees, at least three additional dollars must be invested. For example, Riverside County, California (an urban county in the CDBG Entitlement Program), financed the start-up of a car dealership by packaging together over $3.2 million in private financing, equity investment, and a CDBG loan to use with a $750,000 SBA 504 loan guarantee. This package exceeded the required 2 to 3 ratio.

The achievement of high leveraging ratios may negatively affect other performance measurements. For example, high leveraging ratios may result in the need to accept increased risk. In the Riverside example, the CDBG loan was subordinate to both the SBA and private loans. That is, if the Riverside loan defaults, the CDBG loan is the last to be paid off, because SBA regulations require that their loan guarantees take precedence over other federal funding sources such as CDBG.

Loan Defaults as a Performance Measurement

Perhaps one of the most controversial potential performance indicators for CDBG economic development activities is the percentage of loan defaults. Given the nature of CDBG assistance, which in some cases can be considered as a last resort source of funds, as well as different economic circumstances in different regions of the country, it is difficult to establish an appropriate default rate. A zero default rate may indicate that local grantees are too conservative in the loans they make. In contrast, a default rate that is too high may indicate imprudence. Also, different default rates could be expected in various regions of the country based on regional economies. In the SBA program, for example, default rates were higher in certain parts of the south when the oil industry experienced serious downturns in the 1980s.

Moreover, a group of community development and financial lending institutions stated in the group's lending principles that federal attempts to micromanage lending by requiring federal underwriting standards would be counterproductive. Instead, these organizations recommend that

[3]A Section 108 Demonstration Program targeted to small businesses, which operated in the early 1980s and which required leveraging of private funds, effectively leveraged CDBG funds for economic development at a ratio of 30 to 1.

communities be provided with a range of acceptable outcomes, such as portfolio performance.

Some grantees already track portfolio performance. For example, the Buffalo Enterprise Development Corporation—the organization that manages the city of Buffalo's CDBG economic development program—has experienced only a 4-percent default rate on a loan portfolio exceeding $71 million. This corporation reports that area banks historically have experienced a higher default rate.

Since there are no established default rates for the CDBG Program, one approach could be to look at default rates of other federal economic development programs, especially those that target distressed areas. The Rural Development Administration's business and industry loans have had a default rate close to 22 percent for the program's overall history. Yet, the default rate from 1987 through 1993 has been 6.3 percent. As of August 1993, the default rate for SBA's 504 program was about 4 percent.

Essential Services and Facilities as a Performance Measurement

The extent to which economic development activities provide essential services and facilities to communities is also a potential performance measurement. Vermont's State-Administered Program, for example, gives preference to projects that provide goods or services needed by and affordable to low- and moderate-income residents. Dallas used CDBG funds to help finance a large grocery store in an inner-city area. A CDBG-funded grocery store in an inner city community often fills a void: Inner-city residents may previously have had to travel outside of their community to do their food shopping or pay higher prices at stores that offer a limited range of goods.

The essential facilities a business brings to a community through related infrastructure improvements can also be potential indicators of the effectiveness of the project. For example, rural infrastructure improvements, such as sewers and streets, made with CDBG funds to attract new businesses often directly benefit local residents.

Types and Sizes of Businesses Assisted as a Performance Measurement

The types and sizes of businesses assisted, if part of a local economic development strategy, may be a potential performance indicator. As part of a local strategy, grantees may target certain types of businesses or industries. A locality may take into account the local labor supply or the mix of local businesses that can be tapped to supply inputs to the business. For example, Idaho gives preference to projects that will use Idaho products. Grantees may also seek to target businesses that will broaden the local economic base. As noted previously, Maryland gives priority to assisting businesses that will diversify the local economy, particularly in those areas dependent on the defense industry.

Another popular strategy is to target businesses whose products or services are exported outside the local area. Some communities believe that these export-oriented businesses tend to have more growth potential than those looking primarily to their own community for markets. The popularity of this strategy was demonstrated by the 1990 study by the Council of State Community Development Agencies. The study found that 93 percent of businesses receiving CDBG loans sell over 50 percent of their output outside a radius of 50 miles from their place of business. Manufacturing is a typical example of an export-oriented business. In their 1992 final statements, ten states gave preference to manufacturing firms in funding CDBG economic development projects.

Communities may choose to target a particular size of business because they associate certain positive benefits with that size. For example, large companies have historically offered benefits such as health insurance in a greater proportion than small businesses. Others may choose to target small businesses. According to SBA, small businesses employ almost 60 percent of the private work force and represent 54 percent of all sales in the country. Furthermore, from 1977 to 1987, small businesses were key generators of new jobs, accounting for 68 percent of net new job growth. However, this strategy is not without risk, as officials state that the survival of small businesses in distressed communities is low.

Assistance to resident-owned businesses and microenterprises has been highlighted in recent legislation. The 1990 Cranston-Gonzalez National Affordable Housing Act reemphasized that businesses owned by community residents are eligible for CDBG economic development funding, and the 1992 Housing and Community Development Act reemphasized that microenterprises are eligible.[4] The 1992 act also noted the importance of microenterprises to economic development by encouraging grantees to set aside 1 percent of their CDBG allocations for these businesses.

[4]A microenterprise, as previously noted, is a commercial enterprise employing five or fewer people, one or more of whom owns the enterprise.

Measuring CDBG's Contribution to Broad Neighborhood Revitalization Efforts Is Difficult

One of the major goals of the CDBG Program is neighborhood economic revitalization. Such revitalization is part of many cities' economic development strategies. In many cases implementing this strategy requires the use of CDBG funds in conjunction with other public and private funds and initiatives, including local enterprise zones. However, measuring the extent of any revitalization achieved and CDBG's contribution to the overall outcome is difficult. Yet some qualitative recognition of this contribution seems desirable.

The difficulty in measuring neighborhood revitalization stems in part from the nature of economic revitalization, which goes beyond individual project outcomes, such as the number of businesses receiving CDBG financing. Measuring the effectiveness of revitalization requires capturing the synergistic effect of a combination of public and private efforts as well as other socioeconomic variables. No one factor may dominate in influencing the outcome of a community's strategy. The difficulty of measuring revitalization is exacerbated because these efforts often take a number of years to produce a measurable impact.

For example, a community strategy to entice an "anchor" store, such as a large department store, to locate in a distressed downtown neighborhood could attract other businesses, some of which could be assisted by CDBG funds. Beyond any increases to employment or taxes that might occur, such commercial activity could also provide local residents with better services. In addition, increased commercial traffic could restore vitality to the neighborhood, thereby reducing physical blight. Private lenders might then be encouraged to provide both commercial and residential loans to the neighborhood, further contributing to the revitalization.

In the above example, it is possible to measure the CDBG contribution in terms of individual performance indicators, such as the number of jobs created. However, such measurements may fail to capture the contribution of the CDBG assistance to the overall revitalization effort. More subjective qualitative analysis may be the best available approach for assessing the contribution made by CDBG.

Conclusions

Performance measurements are essential for assessing the impact of CDBG-funded economic development activities, but the grantees are in the best position to determine how their economic development activities should be specifically measured. Some CDBG grantees are already using one or more of a wide range of potential performance indicators. In issuing guidelines required by the Housing and Community Development Act of 1992, HUD has the opportunity to help CDBG grantees better define the performance indicators that would serve them best. However, given the CDBG Program's intended flexibility and the unique economic conditions facing each grantee, federal performance measurements, if promulgated, should be expressed only as broad benchmarks.

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