



ADMINISTRATIVE REPORT

File #: 24-922

Meeting Date: 10/21/2024

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SUBJECT: Authorization to Submit a Formal Request to the U.S. Department of Housing and Urban Development (HUD) Asking for Voluntary Grant Reductions of Future CDBG and HOME Allocations in Lieu of Repayment from Local Funds, Stemming from the January 2020 HUD Environmental Monitoring Findings and Corrective Actions for the Gateway Terrace II Affordable Housing Project

REPORT IN BRIEF

Considers authorization to submit a formal letter to the U.S. Department of Housing and Urban Development (HUD) requesting Voluntary Grant Reductions (VGRs) of future annual Community Development Block Grant (CDBG) and Home Investment Partnership Program (HOME) allocations, in lieu of the use of local funds, for repayment of prior expenditures that HUD determined were ineligible during the January 2020 Environmental Monitoring and as further determined by the October 2021 Monitoring Report that requires repayment of ineligible expenditures as a corrective action.

RECOMMENDATION

City Council - Adopt a motion:

- A. Authorizing the City Manager to submit a formal letter to HUD requesting consideration and approval of Voluntary Grant Reductions of both CDBG and HOME for the respective repayment amounts; and,
- B. Authorizing the City Manager, after consultation with the Finance Officer, City Staff, and HUD, to make the final determination as to the amount and number of years to request the grant reductions to be spread, if any, to ensure that administrative budgetary obligations of the Housing Division are met.

Or

- C. Approving a Supplemental Appropriation from the unreserved, unencumbered General Fund balance in the amount of \$700,507 to repay the ineligible activities.

Or

- D. Approving a Supplemental Appropriation from the unreserved, unencumbered fund balance of Fund 1020 Affordable Housing in the amount of \$700,507 to repay the ineligible activities.

ALTERNATIVES

1. Approve Recommendation A and B, or Recommendation C or Recommendation D; or,
2. Approve, subject to modifications as specified by Council (with modifications specified in the motion); or,
3. Deny the request completely; or,
4. Refer back to staff for reconsideration of specific items as requested by Council; or,
5. Continue item to a future Council meeting (date and time to be specified in the motion).

AUTHORITY

Charter of the City of Merced; and, Pursuant to Title 24 of Federal Code of Regulations Parts 92 and 570.

CITY COUNCIL PRIORITIES

As provided for in the 2024-25 Adopted Budget.

DISCUSSION

City staff requests City Council consideration of authorizing the City Manager to submit a formal letter to HUD that requests a Voluntary Grant Reduction (VGR) of one or both future CDBG and HOME annual allocations in lieu of previously discussed methods and sources (reviewed below) or use of other local funds, for repayment to HUD of expenditures that were found to be ineligible by HUD during an On-Site Environmental Monitoring that was conducted in January 2020.

It should be noted HUD does not require formal action by the legislative body for this type of action; however, Staff felt this request is a significant policy direction and is seeking City Council's feedback and support.

Background - Review

Attached are Administrative Reports (Attachments 2 and 3) that address the strategy and actions taken by City staff to date regarding the corrective actions that HUD required in their October 2021 Monitoring Report, also attached (Attachment 4). The reports outline the steps that were planned to use Low-Mod Housing Asset funds to repay the expenditures.

At the April 2, 2024, Council meeting, Councilmembers received the information regarding the January 2020 environmental monitoring, the resulting findings, and the October 2021 monitoring report that listed the corrective actions necessary.

Housing Division staff last reported this matter to Council on May 6, 2024, when staff sought and received Council approval of termination documents that would cancel and disencumber all prior funding commitment documents and funding that had previously been executed and reserved for the Gateway Terrace II affordable housing project (GTII).

Since the May Council action, staff has coordinated with HUD and carried out the termination of the subject documents. Additionally, staff has continued to work with the developer, Central Valley Coalition for Affordable Housing (CVCAH).

Current Status of Repayments

Currently, there are only two required repayments remaining - the repayment for the property at 1820 I Street, and funds associated with the GTII affordable housing project.

Housing staff will be processing the repayment related to the property at 1820 I Street (\$269,639.99 - HOME funds) using the previously approved LMI Housing Asset funds. This task will be completed near the end of October.

The only repayment remaining is related to the GTII affordable housing project. The amounts to be repaid are: \$307,913.40 (CDBG) and \$392,593.55 (HOME), for a total of \$700,506.95. These amounts include Housing Division activity delivery costs of \$51,318.90 and \$65,532.26, respectively. There are two options for repayment. One is the request of the VGR over 1-3 year period. The other is a lump sum repayment to HUD with local revenue sources. In this case it would be from the General Fund or the Affordable Housing Fund.

Gateway Terrace II Project - Update

The planned GTII repayment process involved using LMI Housing Asset (Housing Successor Agency) funds in place of the former HUD sources to create a new loan. Through an escrow process, funds would have repaid HUD and also provided additional resources to support the project. The City also pledged Coronavirus State and Local Fiscal Recovery - American Rescue Plan Act Funds (SLFRF-ARPA) funds.

As reported in May, GTII is still a viable affordable housing project with full land use entitlements and all impact, connection, and permit fees were paid. Unfortunately, the project is now unlikely to meet deadlines related to the commitment of ARPA. All of the City's allocated ARPA funds are subject to a deadline to obligate to eligible projects by December 31, 2024, and an expenditure deadline of no later than December 31, 2026.

The GTII Site will not be transferred in time to allow the City to commit funds to the project. The site is owned by the Housing Authority of the County of Merced (HACM), who had previously acquired and developed the property with funds provided by the HUD Office of Public and Indian Housing (PIH).

CVCAH has been working with HUD and the Housing Authority on ownership transfer. This step was necessary to allow the City to move forward with the plan to use LMI Housing Asset funds and other sources as alternative funding to the original HUD loans. The transfer process also involves the HUD Office of Multifamily Housing (MFH). CVCAH has completed all steps to move forward; however, HUD has indicated the process would likely take many, many months - well past the end of the year and into 2025.

Additionally, the commitment of City LMI Housing Asset funding requires that a loan be recorded against the property. The property is not able to be transferred given delays with HUD.

Unfortunately, given the property transfer delay within HUD's MFH office, combined with the looming SLFRF - ARPA obligation and expenditure deadlines, CVCAH will not be able to move forward with the project with the current non-HUD funding plan. Staff will continue to work with CVCAH on other non HUD resources to implement the project at a later time.

Other Methods of HUD Repayment - Voluntary Grant Reduction (VGR)

Since the project cannot proceed forward at this time and meet the ARPA deadlines, and the use of the LMI Housing Asset is required to be secured in a loan against the project, there are few options to repay HUD. Staff did meet with the Council Budget Sub Committee and outlined options including the Voluntary Grant Reduction (VGR) of future CDBG and HOME grants allocations.

HUD permits VGRs only on a case-by-case request basis when a city's current fiscal demands make repayment with non-federal (i.e. General Funds) difficult.

Approval comes with some pros and cons that should be considered and planned for. Attachment 1 provides a 2012 HUD Guidance Memorandum that explains these pros and cons in detail. Some points to consider:

- Reduction of CDBG and HOME allocations decreases the amount of program funds available to address affordable housing, community/infrastructure development and public services needs.
- Public services are capped at 15% of the year's CDBG allocation - the amount available for these important services will be affected accordingly.
- Reductions of both CDBG and HOME also reduces the amount of administrative funds the City has available for staffing and general program administration. CDBG admin is capped at 20% and HOME is capped at 10% of the corresponding allocation.
- Reductions result in a "double loss" - loss of the original ineligible expenditure(s) and loss of future allocations.
- Repayments oftentimes result in the original ineligible CDBG/HOME funds being given back to the City to re-allocate to another eligible project (depending on the age of the original funding).
- The City's proposal to reduce future allocations must be made public, including during the Consolidated Plan and Annual Action Plan planning, preparation, and citizen participation process.
- With the amount of administrative funding reduced, the City will likely need to augment the Housing Division administration and staffing budget with other funds (potentially Affordable Housing Funds).

The HUD guidance memo explains that VGRs may be accepted as repayment in cases where communities are experiencing significant fiscal distress. A request for a VGR is not automatically granted and must be approved by the HUD Office of Community Planning and Development. The City's reason for its fiscal distress must be documented, including its inability to repay with other non-federal sources. Additionally, the City must waive its right to a hearing that normally would be allowed pursuant to 24 CFR 570.913 (CDBG) and 24 CFR 92.552(a) (HOME).

Due to flat lining in local revenue, reduction of residential building permits, inflation and significant increase to labor agreement costs over the next three years, the City of Merced would likely have difficulty in maintain a balanced budget. Any available savings or fund balance should be kept to be able to pay future year obligations.

Generally, reductions must be made in a single year - however, when the amount of repayment represents a high percentage of the annual allocation(s) or the reason for fiscal distress can be factored in, HUD may authorize a period of up to three (3) years to complete the reduction.

The below calculations illustrate how much may be reduced from each grant per year, in a scenario of a two- or three-year spread:

Grant Resource:	Total amount of repayment:	Reduction/yr @ 2 year spread:	Reduction/yr @ 3 year spread	Overall reduction to Admin Budget
CDBG	\$ 307,913.40	\$ 153,956.70 / yr	\$ 102,637.80 / yr	(\$61,582.68)
HOME	\$ 392,593.55	\$ 196,296.78 / yr	\$ 130,864.52 / yr	(\$ 39,259.36)

One year of a normal CDBG allocation range of approximately \$900,000 - \$1,125,000 may be able to withstand the full CDBG repayment reduction taken in one year, without spreading over two or three years. However, the normal HOME allocation is much less (2024 allocation is just \$450,563.61) and would not likely be able to withstand taking the repayment reduction in one year, unless substantial contribution to the Housing Division administrative budget is made with another local source, such as the General Fund or Affordable Housing Fund.

Housing Division staff requests that Council authorize the City Manager the ability to work with the Finance Officer and Housing staff to determine the best path forward. Recommendations for the any shortfall in Housing Administration would be part of the Mid-Year or Annual Budget process.

IMPACT ON CITY RESOURCES

Option One

A reduction of the annual CDBG and HOME grants of any amount will affect the administrative funds that the Housing Division depends on to cover direct and indirect costs of running HUD programs, as well as covering staff salaries and wages. This is based on HUD’s caps on the percentage of each grant that can be spent for administrative and planning activities.

HUD treats administrative caps differently between the two grants. Indirect and direct costs from each year’s CDBG allocation are capped at 20% of total funds, with indirect costs being charged at no more than 10%. Direct CDBG administrative costs are charged at 10% plus the balance of what is not used by indirect costs during the year.

Comparatively, only direct administrative costs can be charged to the HOME allocation, and such direct charges are capped at 10% each year.

As such, any reduction to each allocation will result in less administrative funding being available to the Housing Division. If the allocation(s) are reduced too much in any one year against accumulated administrative costs, other local funds may need to be appropriated to cover any administrative cost deficit(s).

If any shortfalls in the Housing Administration Fund are projected due to reductions in funding available for administration, staff will provide recommendations for filling the gap as part of the Mid-Year budget review and adjustments or the Annual budget adoption process.

Option Two

The Affordable Housing Fund has a balance of \$881,017 as of 6/30/24. The City Council can choose to pay a lump sum of \$700,506.95 from this fund as the GTII project would have met the Affordable Housing Policy for use of the funds.

Option Three

The City Council can also choose to pay a lump sum amount of \$700,506.95 from the General Fund but it would reduce funding available for future operating costs or obligations.

Option Four

The City Council may also choose to use a mixed amount of funding to repay the lump sum amount. For example, they can vote to repay the amount to HUD with 50% from the General Fund and 50% from the Affordable Housing Fund.

ATTACHMENTS

1. HUD Guidance Memo - Voluntary Grant Reductions in Lieu of Repayment
2. April 2, 2024, Admin Report
3. May 6, 2024, Admin Report
4. October 21, 2024, HUD Environmental Findings Report