



ADMINISTRATIVE REPORT

File #: 24-009

Meeting Date: 4/2/2024

Report Prepared by: Kimberly Nutt, Housing Program Supervisor, Housing Division/Development Services Department; with Scott McBride, City Manager

SUBJECT: Approval of a Resolution Acknowledging the October 28, 2021, Environmental Monitoring Report Regarding Community Development Block Grant (CDBG) and HOME Investment Partnership Program (HOME) Fund Activities by the U.S. Department of Housing and Urban Development (HUD); Pledging the City's Intent to Prohibit Use of HUD Funds Towards the Projects Identified in Finding 1 of the Monitoring Report; Transfer and Assignment of Previous Home Investment Partnership Program (HOME) Affordability, Deed, Note, and Loan Agreements to HSA/Housing LMI Asset Funds for the 1820 I Street Project; Authorizing the Use of Housing Successor Agency (HSA)/Housing LMI Asset Funds to Satisfy the Listed Corrective Actions for Local Fund Repayment of Expended HUD Funds

REPORT IN BRIEF

Considers formal acknowledgement of the October 28, 2021, On-Site Environmental Monitoring Report by HUD by means of adoption of a Resolution by City Council. This acknowledgement includes agreeing to abide by the Corrective Actions that are required by HUD to rectify the findings noted in the monitoring report. Corrective actions include repayment, using a non-Federal or local fund source, of noncompliant CDBG and HOME expenditures, as identified during the monitoring, and approval of the Resolution would authorize the use of HSA Housing LMI Asset Funds to be used as the local funding source for all remaining repayments that are to be completed. As part one of a two-part process to address the remaining required corrective actions, this approval also includes authorizing the de-obligation and transfer and assignment of all current HOME affordability, deed, note, and loan commitments and agreements associated with the project at 1820 I Street to HSA LMI Asset funds; and authorizing the City Manager to execute all related documents and agreements and the Finance Officer to encumber and appropriate funds and carry out all other necessary actions related to the repayment and the new HSA loan agreements.

RECOMMENDATION

City Council - Adopt a motion:

A. Approving **Resolution 2024-42**, a Resolution of the City Council of the City of Merced, California, Acknowledging the October 28, 2021, Environmental Monitoring Report Findings and Corrective Actions Required by the US Department of Housing and Urban Development (HUD) to Regain and Ensure Current and Future Compliance with the Provisions of the National Environmental Policy Act (NEPA) and All Associated Regulations; and,

B. Authorizing the City Manager to execute all necessary documents on behalf of the City of Merced

Housing Successor Agency, including, but not limited to, transferring and assigning the original HOME fund Affordability, Deed, Note, and Loan documents for the 1820 I Street project to HSA LMI Asset Funds (Attached); and,

C. Authorizing the Finance Officer to make all necessary budget adjustments to support all actions and transactions needed, as may be deemed essential, including those needed to facilitate, transmit, receive, and send funds; and,

D. Authorizing the City Manager to execute all other documents, subject to review and approval by the City Attorney, which may be necessary to implement these activities.

ALTERNATIVES

1. Approve as recommended by staff; or,
2. Deny; or,
3. Refer to City Staff for reconsideration of specific items to be addressed in City Council motion; or,
4. Continue to a future City Council meeting (date and time to be specified in City Council motion).

AUTHORITY

Charter of the City of Merced, Section 200, et seq., California Government Code; and, Code of Federal Regulations (CFR) applicable to the administration and financial management of HUD funds.

CITY COUNCIL PRIORITIES

Fiscal Year 2023-2024 Goals and Priorities for Housing and the Unhoused in support of affordable housing projects.

DISCUSSION

Background

January 2020 Environmental Monitoring:

In mid-January 2020, HUD conducted an on-site monitoring of the CDBG and HOME programs to assess the City's compliance with applicable Federal requirements, with a focus on the level of compliance achieved with the provisions of the National Environmental Policy Act (NEPA). The City's performance was assessed by HUD through a review of operations, file documentation, interviews, and drive-by inspections of a total of 26 project activities selected from 2014-2018 Annual Action Plans.

HUD's review of various areas of program performance resulted in a determination that the City had generally ensured that CDBG and HOME funds were compliant with NEPA and applicable environmental laws, Executive Orders, and other requirements -- however, the monitoring identified two Findings of deficiency in program performance (no Concerns).

For purposes of clarification, a "Finding" is a deficiency in program performance based on a violation of a statutory or regulatory requirement, and a "Concern" is a deficiency in program performance that is not based on such a violation but is brought to the City's attention. Following a monitoring by

HUD, a monitoring report is typically prepared by HUD staff in a timely manner and supplied to the City that lists all Findings, Concerns, and Corrective Actions that are required to address any findings of noncompliance.

Upon completion of the on-site monitoring, City staff was verbally informed of the two Findings identified; however, HUD did not provide the City with its written monitoring evaluation report, which lists the specific violations and the actions required to resolve the Findings, until its receipt in early November 2021 (Attachment 1 - Environmental Monitoring Report dated October 28, 2021). The funds associated with the project activities identified in the Monitoring Report were suspended by HUD shortly after the January 2020 on-site monitoring was completed.

Findings and Projects Identified in the Monitoring:

The two findings were:

1. Finding #1 - "HUD program funds were committed to a choice-limiting action prior to submission of the Request for Release of Funds and Certification, a statutory violation of Section 104(g)(2) of the Housing and Community Development Act of 1974 and Section 288 (b) Title II of the Cranston-Gonzales National Affordable Housing Act, and which also were regulatory violations of Part 58."
 - Projects/Activities listed under Finding #1:
Gateway Terrace II Affordable Housing Project (HUD Activities 1103 and 1102)
New Construction of Multifamily Residential [1820 I Street] (HUD Activity 1063)
South Merced ADA Ramp Project #116033 (HUD Activity 1067)
ADA Ramp and Sidewalk Modifications #117007 (HUD Activity 1094)
Room at the Inn - Merced County Rescue Mission (HUD Activity 1095)
 - What this means:
In Finding #1, the City was unable to provide completed environmental reviews for six HUD activities. HUD determined that the City did not conduct environmental reviews as required under 24 CFR Part 58 and that regulatory, loan, and other Council-approved agreement documents that formally committed HUD funds were executed prior to completion of the required NEPA environmental reviews. Additionally, because HUD funds were expended without those reviews completed, these expended funds must be repaid from a non-Federal or local funding source as part of the required Corrective Actions listed in the Monitoring Report.
2. Finding #2 - "The City failed to retain the written records of the broad-level review, Tier I of its Tiered environmental review approach."
 - Project/Activities listed under Finding #2:
Homeowner Rehabilitation - Brush With Kindness Program (Activities 1076, 1080, 1086, and 1087)
 - What this means:
Finding #2 is similar to Finding #1, in that the initial broad-level "Tier 1" review was not retained or found on file for the overall program activity - however, each "Site-Specific

Tier 2" review was completed and retained its individual project file, and City staff was able to provide these for the HUD reviewer. Thus, the City could show, by each of the four Tier 2 site-specific reviews on file, a clear determination and certification that no harmful effect to either the environment or building occupants would come by carrying out each rehab project involved. For only Finding #2, the City was prohibited from completing any further Tier 2 projects under that project/activity, but was permitted to completely restart the activity with a new Tier 1 review using HUD funding. Previous related Subrecipient Agreements have expired.

Finding #2 - Update:

This activity was restarted with the 2022 Annual Action Plan with Habitat for Humanity Merced/Stanislaus, with a compliant Tier 1 completed as required by NEPA. The new Brush With Kindness Homeowner Rehabilitation Program was approved by City Council as a three-year program spanning Annual Plan years 2022, 2023, and 2024.

Except for the development of environmental policies and procedures discussed further below, Finding #2 has been resolved.

Progress on Finding #1 Corrective Actions to Date:

- Room at the Inn - Merced County Rescue Mission (HUD Activity 1095)

Following the receipt of the Monitoring Report, staff performed another deep search of program files and was able to locate a copy of the completed environmental review with the program subrecipient (Room at the Inn - Merced County Rescue Mission; Activity 1095). This environmental review was completed in a compliant manner, and associated subrecipient agreement execution and expenditures were completed in the correct sequence. Thus, this project/activity is no longer part of the repayment requirements and is no longer considered noncompliant.

- South Merced ADA Ramp Project #116033 (HUD Activity 1067); and, ADA Ramp and Sidewalk Modifications #117007 (HUD Activity 1094)

The City allocated 2015 CDBG funding towards two infrastructure projects, and environmental reviews for each could not be provided to HUD during the January 2020 monitoring. These projects also disbursed funding to complete the infrastructure work, and the Monitoring Report corrective actions required that these expenditures be repaid.

On August 29, 2023, Housing Division staff completed the administrative actions needed in HUD's online data and disbursement system to repay these funds to HUD using local Measure C funds as the required local funding source. Council approved the use of \$222,687 of Measure C funds for the repayment at the February 21, 2023, Council meeting, as a budget adjustment included in the Mid-Year Budget Review for Fiscal Year 2022-2023.

After this repayment, HUD returned the CDBG funds back to the City to reuse, and these funds were included as current year (Program Year 2023-24) program income in the 1st

Substantial Amendment to the 2023 Annual Action Plan, so that they could subsequently be used towards the purchase of the vacant land for the future Devonwood Apartments project.

As these funds are now repaid, this piece of the required corrective actions for Finding #1 has been resolved.

Remaining Corrective Actions Part 1 - 1820 I St

The City made HOME funding commitments to CVCAH in program year 2016, expenditure from which assisted the construction of a single-family home to replace a previously demolished duplex at 1820 I Street, where there was also an existing single family home fronting W. 18th Street. The property was and is currently owned by Central Valley Coalition for Affordable Housing (CVCAH), the developer and non-profit organization who was provided the subject HOME fund loan for the reconstruction. The Monitoring Report requires that all previously paid expenditures for the reconstruction must be repaid as part of the Corrective Actions.

Since November 2021, City staff has held multiple discussions with various representatives from HUD to review and address the Findings and determine how best to negotiate through the complicated corrective actions in a logical but effective manner. Given the scope and complexity of the issues, work has also been coordinated with the City Attorney's Office, City Finance Department, outside Title Officers, and community partners specifically associated with projects or activities listed within the Monitoring Report.

As HUD's most blaring corrective actions focus primarily on repayment of financial expenditures, the goal has been how to repay HUD and preserve projects that were involved in the monitoring, but that currently have active HUD-funded loans (1820 I Street) or have not even broken ground (the GTII project).

This collaborative work has identified a two-part path forward that will enable funds from the affected 1820 I Street project to assist in funding the GTII project. Part one involves, first, the assignment and assumption of previous CDBG and/or HOME deed restrictions, affordability requirements, loan agreements, and related other agreements by a local funding source, which will be HSA LMI Asset funds; and second, the repayment of funds to HUD.

1820 I Street Agreements - Transfer of Loan Funding Source

The 1820 I Street project still has the Affordability Restrictions on Transfer of Property and the Deed of Trust and Security Agreement in effect, which ensures an affordability period of 30 years by restricting the amount of rent that can be charged for the rental housing units and the income level that the units can be rented to. All current HOME-related affordability, deed, and loan/note-related documents are attached to this report (Attachments 5 to 8).

To address this item, Staff is recommending that the executed loan documents be assigned to the City as the Housing Successor Agency (HSA), which then transfers the funding source of the loan from HOME to HSA LMI Asset funds.

This action is similar to the common practice by mortgage financing companies when they sell off loan portfolios to other mortgage companies - the loans of which are then transferred and assigned to the new mortgage company as the new holder of the loan note, and the homeowner then begins sending their monthly loan payment to a different mortgage company. In this case, the current HOME loans are transferred to HSA, and CVCAH then begins paying the Housing Successor Agency, not the City's HOME fund account.

To implement this action, staff is recommending that the City Manager be authorized to execute the following (Attachments 2 to 4):

- Assignment and Assumption of Notice of Affordability Restrictions on Transfer of Property - this notice augments the Substitution and Full Reconveyance document by providing additional notice that there are affordability restrictions placed on the property.
- Assignment of Deed of Trust - ensures that the existing financing is now secured in favor of the Housing Successor Agency (HSA) instead of the City of Merced.
- Approving a Substitution of Trustee and Full Reconveyance - document substitutes a new Trustee, the Housing Successor Agency, instead of the City of Merced. This allows for the affordability covenant to remain in place.

Transferred/Assigned (New) HSA Loan Payoff

Additionally, CVCAH has expressed their desire to completely pay off the loan balance and any interest due, the sequence of which would occur after transfer and assignment of the agreements to HSA. With the loan being transferred to the HSA, the loan payoff is then paid to HSA funds (would no longer be HOME program income), and the available balance of the HSA Fund would increase accordingly.

1820 I Street - Repayment

The HOME funding commitment and expenditure was \$269,639.99 in total. It included \$224,700.00 project costs and \$44,939.99 charged as a Housing Activity Delivery Cost (ADC) for Housing Division administration.

As funds must be repaid from a non-Federal or local funding source, staff requests City Council approval to use HSA LMI Asset funds for the repayment.

As such, the City Council is requested to authorize the following fiscal adjustments including increasing revenue and expense by the Finance Officer for the repayment to HUD:

- 1820 I St. - Call Note including interest due to payoff (approximately \$235,264) the Housing Successor Agency Loan Agreement by CVCAH and deposit paid off funds in Fund 2513 - LMI Housing
- Increase to revenue and expense in Fund 2513-LMI Housing to accept note payoff and to

repay noncompliant HUD expenditures for 1820 I St. project.

- Increase revenue in Fund 2502-Federal Home Program to accept repayment of HUD ineligible project costs which will be allocated through a new Annual Action Plan or amendment process to support future eligible activities.
- 1820 I St repayment to HUD - In HUD's online data and disbursement system or other process at HUD's direction, complete all repayments of noncompliant HUD expenditures for the 1820 I Street project in the amount of \$269,639.99.

Remaining Corrective Actions Part 2 - Gateway Terrace II *(future City Council meeting)*

The GTII project is still a viable affordable housing project that has full entitlements, approved building plans, approved civil plans, and all impact, connection, and permit fees have been paid.

The City Council has previously provided direction to use Housing Successor Agency (HSA) funds towards support of this project, which would satisfy HUD's requirement that ineligible funds be repaid by non-Federal or local sources.

Following payoff of the balance of 1820 I Street project loans into the HSA LMI Asset Fund (after transfer/assignment from HOME to HSA funds), there may then be excess LMI Asset funds available that could be provided to the GTII project. Thus, GTII will be "Part Two" of this planned repayment process.

Additionally, the HSA LMI Asset funds have an impending expenditure deadline of June 30, 2024. Therefore, City staff will return to Council this spring to resolve matters with the GTII project that currently prohibit its progress.

Administrative Environmental Review Procedure Oversight

The Monitoring Report also identified two areas that involve administrative oversight - continuing ongoing training and development and the preparation and implementation of new Environmental Review Policy and Procedures, the latter of which Housing staff has been working with HUD to develop since the monitoring. As drafting of these policies involves much time and detail, HUD staff has extended Housing staff additional time to complete these policies and procedures in light of current heavy workloads and short staffing levels/new staff.

City staff that is involved in and performs any level of NEPA environmental review has been and will continue to participate in regular NEPA training annually, when new training sessions are announced by HUD, or when HUD implements new procedures or requirements, such as in January 2024 with new policies for considering radon gas testing in site contamination analysis (effective April 2024). New staff members have been required to complete NEPA module training through HUD's website. Current Housing staff remain vigilant in ensuring that the mistakes identified in the 2020 monitoring of 2014-2018 projects do not occur again. Staff has developed a mutually cooperative relationship with HUD staff in this respect and discipline.

IMPACT ON CITY RESOURCES

As part of the cleanup process, where activities have been deemed to be ineligible and noncompliant

by HUD, they must be repaid using a non-Federal or local funding source, which can be HSA LMI Asset Funds, which are available to use.

It is staff's understanding, based on conversations with the City's HUD representatives, that these repaid HOME funds may then be returned by HUD to be re-purposed towards eligible program activities in the next Annual Action Plan cycle, likely 2024-25. To access those funds, they will need to be included in HUD Annual Action Plans as prior year program income/resources for reallocation to new projects by the City Council through approval of the plan's project list.

The recommended actions by the City Council will authorize the Finance Officer to make budget amendments and appropriations to support the actions described in the report.

ATTACHMENTS

1. HUD CPD Environmental Monitoring Report, October 28, 2021
2. Assignment and Assumption Notice of Affordability Restrictions on Transfer of Property (Housing Successor)
3. Assignment of Deed of Trust (Housing Successor)
4. Substitution of Trustee and Full Reconveyance (Housing Successor)
5. Notice of Affordability Restrictions on Transfer of Property Relating to HOME Investment Partnerships Loan
6. Deed of Trust and Security Agreement in Respect of the HOME Investment Partnership Program (1820 I Street)
7. City of Merced HOME Note (1820 I Street Apartment Project - HOME Loan)
8. 1820 I Street Loan Agreement in Respect of the HOME Investment Partnership Program
9. Resolution 2024-42