Agenda # 9.1

City Council

Staff Report

TO: Honorable Mayor and City Council

FROM: John Jansons

DATE: August 22, 2016

SUBJECT: CDBG and HOME Program Income.

RECOMMENDED ACTION:
It is respectfully recommended that the City Council hear a presentation form Staff on the regulations and permitted uses of Program Income derived from federally funded activities with possible direction to staff.

BACKGROUND:
At the request of Mayor Pro Tem Boyer, the City Council directed staff to facilitate a discussion about the regulations and permitted uses of Program Income derived from Federally-funded programs (CDBG or HOME activities).

DISCUSSION:
Program Income are repayments received by the City from previously grant funded activities associated with CDBG or the HOME program(s). The simplest example is if a first time homebuyer down payment assistance loan is repaid prior to its maturation, then the re-payment received by the City, as the note holder, is treated as Program Income (PI).

Typically, PI accumulated by a City needs to be spent down before the City is allowed to draw new grant funds from their current grant award.

One exception is the "$35,000 rule", which allows an Agency with a PI balance of less than $35,000 to use those funds as they see fit for general public benefit purposes without affecting their ability to utilize current grant period funds.

CDBG and HOME program staff from Self Help Enterprises, the City's contractor to deliver CDBG and HOME funded activities are present this evening to further elaborate on the sues and restrictions on PI and to address questions of the Council and assist in formulating a plan for the City Council to utilize PI for the public benefit of the residents of Farmersville.

In support of this discussion is **Attachment 1**, an overview of Program Income provided by the CA Department of Housing and Community Development.

COORDINATION & REVIEW:
This is discussion has been coordinated with the City Finance Department, Community Development Department and the City's contractor for CDBG and HOME, Self Help Enterprises.

FISCAL IMPACT:
None

ALTERNATIVES:
None

CONCLUSION:
It is respectfully recommended that the City Council hear a presentation form Staff on the regulations and permitted uses of Program Income derived from federally funded activities with possible direction to staff.

ATTACHMENT: Program Income - Information and Guidelines.

Respectfully Submitted:

John Jansons
City Manager

Attachment 1

STATE OF CALIFORNIA - BUSINESS, CONSUMER SERVICES, AND HOUSING AGENCY EDMUND G. BROWN JR., *Governor*

DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT
DIVISION OF FINANCIAL ASSISTANCE
Community Development Block Grant Program
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CDBG MANAGEMENT MEMORANDUM

Community Development Block Grant Program - Memorandum Number 14-05

June 16, 2014

MEMORANDUM FOR: **Non-Entitlement Jurisdictions Eligible for the State Community Development Block Grant (CDBG) Program**

FROM: **Thomas Brandeberry, CDBG Section Chief**

SUBJECT: **Program Income (PI) Rule Changes**

This Management Memo (Memo) supersedes the following Program Income Memos: 10-03, 11-04 and 12-03. However, Memo 14-02 is still applicable.

Note: *The applicability of this memo also includes cities and counties that have gained entitlement status and cities within urban county agreements which have elected to continue to report their State CDBG PI to the State. See,* "Jurisdictions Leaving or Entering the State CDBG Program with Program Income," *page 11, for specific requirements/limitations.*

REGULATORY/STATUTE CITATIONS

- Section 104(j) Housing and Community Development Act (HCDA)
- §570.489 (e) Program Income
- §570.489 (f) Revolving funds

Introduction

This Memo outlines changes, **effective July 1, 2014**, to PI and RLA policies in the State CDBG Program.

Based on direction from HUD and technical assistance from HUD contractors, the Department has determined the State's present rules on Program Income (PI) and Revolving Loan Accounts (RLA) are out of compliance with CDBG federal statute and regulations. Policy and procedure changes must be made to resolve existing programmatic compliance issues related to the CDBG Final Rule (effective May, 2012), and with the State's current PI/RLA rules.

The changes that are necessary for the Department to operate in compliance are significant and range from changes in policy, to fully restructuring CDBG PI accounting and reporting

practices at both the State and local levels. These changes will impact all of our grantees in varying degrees, grantee with large PI balances most significantly.

For this reason, the Department completed six Roundtable meetings and two Advisory Committee meetings which: 1) discussed the significance of the changes; 2) gathered feedback on corrective options, and; 3) discussed how the options may be implemented so the HUD required Department policy can be formulated. The Department has also been in extensive consultation with HUD and HUD TA providers to ensure the policy will be in compliance and to make certain our grantees have the best available options to continue to complete valuable CDBG activities with their CDBG PI and RLA funds.

HUD understands the Department has a very large task to complete and that we cannot create the PI policy retroactively. Therefore, any changes in policies and procedures herein will have a **July 1, 2014 effective date**.

NOTE: The most significant rule change, effective July 1, 2014, is:

- ***Funds on-hand determined to be PI must be used prior to drawing down any awarded grant funds.***

Also Note: Based on the CDBG federal Final Rule change, all PI/RLF expenditures, along with activity accomplishments, must be entered into the Integrated Disbursements & Information System (IDIS) beginning July 1, 2011.

NEW POLICY - Revolving Loan Fund

REVOLVING LOAN FUND - HUD uses the term Revolving Loan *Fund* (RLF), not Revolving Loan *Account* (RLA), (which is a State term). The Department, to distinguish between past practices and those implemented with this Management Memo, effective July 1, 2014, is now using the HUD term "RLF."

As of July 1, 2014, all State RLAs are cancelled since HUD has determined the State's RLAs do not meet the RLF definition. This means that until a grantee follows the steps to create an eligible RLF outlined below *and receives the Department's approval for the RLF*, ***all funds on hand and within the grantee's loan portfolio are considered PI*** and, therefore, must be used prior to drawing down grant funds from any CDBG contracts.

REVOLVING LOAN FUNDS:

Grantees have the option to establish RLFs under these two RLF definitions only:

1. **Housing RLF:** Activities are limited to Homebuyer Assistance (13), Owner Occupied Rehab (14A), and Tenant Occupied Rehab (14B), and are limited to 1-4 Units. (Multi-family activities, or those with 5 or more units, are *not* considered part of the Housing RLF activities.)

2. **Economic Development RLF:** Activities are limited to Microenterprise Financial Assistance (18C) (no grants), and Business Assistance (18A) (limited to Special ED).

The above defined RLFs will allow grantees the maximum number of activities to capitalize the RLF and ensure the RFL will have sufficient funds to revolve.

RLF RULES:

a. RLFs can only use financing instruments that revolve. Therefore, RLFs cannot fund ***projects*** that are ***solely*** grants or forgivable loans.

b. A grantee cannot establish a RLF unless:
   1) the grantee has made loans in the past for the same RLF activity; **and,**
   2) the grantee has received loan payments from the same RLF activity.

c. Funds within a RLF can only be from activities defined by the RLF, as listed above. This means RLF monies must go out in loans and come back as payments for the same RLF activity. Funds received for RLF activities cannot be "diverted."

d. Once a RLF has been established and approved by the Department, no funds can be used for any other CDBG activity, committed to any contract to supplement a grant funded project, or transferred to another RLF(except as noted below).

e. Moving funds out of an RLF requires Department approval and will only be allowed under limited circumstances (for a natural disaster, for example). Once approved, the funds will be considered PI; and, therefore, must be used prior to drawing down grant funds. Additionally, this action could result in the Department cancelling the grantee's RLF due to a lack of ability to revolve (insufficient funding).

f. When calculating the 17% General Admin (21A) funds on the received PI in a given year, funds received for an RLF may not be included in this calculation.

g. Associated Activity Delivery (AD) costs can only be reported and included in the definition of "revolving" when actual accomplishments are reported within the fiscal year. This means no AD may be charged to the RLF within a fiscal year if no loans were made within that fiscal year.

h. When a grantee has been approved for an RLF, those funds must be placed within a separate set of accounts (grantee will be required to create a separate fund/ transaction number) for each approved RLF. *This will also require all other CDBG funds received from CDBG activities be accounted for as PI.*

i. If a grantee has awarded grant funds for the same activity as their approved RLF and there are insufficient RLF monies to fund an entire activity, the grantee can "split-fund" a project (RLF funds first) when the project needs additional funds beyond the amount of RLF monies on-hand.

j. *Projects funded solely with grants are not considered RLF and, therefore, can be funded with awarded grant funds. To qualify as an RLF eligible activity, there must be the possibility of repayment, so only deferred loans and performing loans are eligible.*

k. Grantees cannot "bank" RLF monies. To remain eligible, a RLF must revolve. Thus, a grantee cannot have more than $100,000 on hand in a RLF within a given fiscal year, without making at least one loan. Additionally, grantees may not have more than $500,000 on hand even if making loans, each fiscal year. The Department will address these issues by issuing finding letters to the grantee which could result in the Department cancelling the grantee's RLF, which immediately converts the funds to PI; and, therefore, must be used prior to drawing down grant funds.

Note: The Department reserves the right to cancel the grantee's RLF and require the funds to be returned to the Department as a corrective action for significant, ongoing non-compliance with RLF rules.

STEPS: MOVING FROM RLA TO RLF

As of July 1, 2014, grantees do not have Revolving Loan Funds until the following has been completed. Thus, as of July 1, 2014, all funds on hand are considered PI and must be used prior to drawing down any grant funds.

As of July 1, 2014, the following steps must be followed to establish an RLF:

1. Grantee must decide if they wish to create one or both of the RLFs as replacement for their present RLAs. If not, the grantee must begin the new process of accounting for all current RLA funds and PI on hand as PI.

2. If the grantee decides to create one or both of the RLFs, they must:

   a. Certify the amount of funds currently on hand which are from the same activity that the grantee wishes to fund each RLF;

   b. Certify the amount of funds in their loan portfolio which have come from the same activity and will continue within the RLF when payments are received; and,

   c. Certify the amount of funds, both on hand and within the loan portfolio, which are not from the same activity. This includes funds on hand, funds within the RL***A***, or funds within the loan portfolio where the grantee cannot identify the activity that generated the funds; these funds will be considered PI and must be accounted for as such.

3. The grantee must have approved guidelines for each activity within the RLF, as listed below. These RLFs are consistent with the CDBG Program's "Combo" Activities:

   Housing RLF:
   - Owner Occupied Rehabilitation
   - Tenant Occupied Rehabilitation (if allowed in the grantee's program)

- Homebuyer Assistance

Economic Development RLF:

- Microenterprise Financial Assistance
- Special Economic Development Business Assistance

Note: Once the grantee has identified portfolio loans as being within an RLF, the loans must be individually coded to indicate they are part of the RLF, which will ensure any payments are correctly accounted for and reported into the RLF.

4. Complete all needed Board Resolutions and Citizen Participation requirements.

   Note: Certification must be made, in writing on the grantee's letterhead, be signed by the Authorized Representative, and must be submitted to the Department with all supporting documentation.

5. The Department will provide a written decision on the RLF request. Until grantees receive the Department's written approval, the RLF does not exist and all CDBG revenue is considered PI and must be spent prior to requesting a draw of grant funds.

NEW POLICY - Program Income When the Grantee has an Active Contract

For the purpose of this section, an Active Contract means the grantee has an executed Standard Agreement (contract) for CDBG activities and the expenditure deadline has not passed.

ANNUAL PROGRAM INCOME RECEIVED THAT IS LESS THAN $35,000

In May 2012 the CDBG federal Final Rule changed this amount from $25,000 on all funds received by the grantee *to* $35,000, *but clarified that it only applies to PI*. Any RLF funds must stay RLF and cannot be included in the $35,000 calculation. The $35,000 rule is found in the CDBG federal regulations defining when proceeds received from a CDBG activity are *not* considered PI. The $35,000 is based on a fiscal year and since it applies only to PI, the rule now requires that grantees certify at the beginning of each fiscal year whether or not they intend to utilize the $35,000 rule.

If a grantee does intend to use the $35,000 rule, they must:

a. When requesting grant funds, certify the amount of PI on hand that have been received during that fiscal year;

b. Not expend any of these funds until the fiscal year is over, unless they received greater than $35,000, at which point the grantee must expend the PI first prior to requesting any grant funds Use all PI carried over from the prior year;

c. Use the PI once the amount of PI received reaches $35,000 within the fiscal year; and,

d. Have adequate accounting records to verify, to the Department's satisfaction, they received less than $35,000 in CDBG PI in a given fiscal year. This must be reported on the semi-annual PI Reports.

If a grantee does not intend to use the $35,000 rule, all revenue received (even if under the $35,000 limit) is CDBG PI and must be used prior to requesting any grant funds.

Revised Funds Request forms are necessary to document the grantee's certification regarding the $35,000 rule. Therefore, the Department will be releasing the Revised Funds Request forms under a separate Memo.

PI RETURNED TO THE STATE

Jurisdictions that have PI on hand and have not applied for or been awarded CDBG funds with the past three NOFAs will be required to submit a PI Expenditure Plan for their PI on hand. The plan must be submitted via the CDBG PI Waiver process, and if they do not initiate the request, the Department will send the grantee a letter requiring submission within a set time frame. If the grantee does not respond to the Department's letter, the grantee will be required to return all PI on hand to the Department, regardless of the amount of PI.

NEW PI RULES – *(PI Revenue; not revenue from an approved RLF)*

1. Program Income must be used prior to requesting a draw of grant funds from any contract. For example, if a grantee incurs costs on a grant funded project *and* has PI on hand, the PI must be used first and the grantee cannot request grant funds until all PI has been paid out.

2. Grantees cannot "commit" (or set aside) PI to an active contract; PI funding must be applied to the next CDBG cost to be paid.

3. PI Waiver projects (set aside PI funds) can only be approved if there is no active contract.

4. If the revenue cannot be associated with an approved, defined RLF, the funds will be considered PI and, therefore, must be used first.

STEPS: ACTIVE 2012 OR 2013 CONTRACTS

Approving PI waivers when a grantee has an active contract is out of compliance with CDBG federal regulations because PI Waivers are funded with PI and PI must be spent first.

As of July 1st, the Department will allow grantees to amend their current active contracts to add "Supplemental Activities." This will allow awarded grant funds that have been supplanted by PI to be used for programs and projects identified by the grantee. Since the

requirement of using PI first will likely result in contract funds being "left over" in the contract, "left over" funding will roll to the grantee's Supplemental Activities, allowing the grantee an opportunity to complete additional CDBG eligible activities so that they do not lose the awarded funds due to having PI.

To initiate Supplemental Activities

a. The grantee must complete and submit to the Department a "Supplemental Activity Inquiry Form," signed by the Authorized Representative, along with any necessary supporting documentation.

b. The Department will review the Supplemental Activity Inquiry Form for eligibility and meeting National Objective.

c. If approved, the grantee will be required to complete the citizen participation process and submit a final resolution approving:
   1) the submission of the PI Supplemental Activity(ies); and,
   2) the amending of the grantee's contract.

d. Any approved waiver activities that have not been fully expended by July 1, 2014 must be added as "Supplemental Activities" through a contract amendment.

2014 CONTRACTS

Once a jurisdiction receives an award letter, the above steps must be taken to add any Supplemental Activities and/or existing waiver projects that have not been fully expended and are not identified as being added to an active 2012 or 2013 contract.

STEPS: FOR 2015 CONTRACTS

When a jurisdiction applies for funding under the 2015 CDBG NOFA, "Supplemental Activities" will be identified in the application if the jurisdiction wishes to have grant funds (if awarded) available to complete activities that would have been funded with PI . Including these activities in the contract will allow grant funds (if awarded) to roll to the Supplemental Activities, since if a jurisdiction has any PI on hand it must be used to complete the active contract activities before grant funds can be drawn. The amount of grant funds equal to the PI paid funds can be rolled into funding the Supplemental Activities. The 2015 NOFA will include the steps necessary to add "Supplemental Activities" to the application.

From 2015 and forward, PI waivers will not be added to active contracts. This means any PI waiver projects must be completed prior to drawing down grant funds since waivers are funded by PI, and PI must be expended first.

NEW POLICY - Program Income When the Grantee Does Not Have an Active Contract

When a jurisdiction does not have an active contract, the PI Waiver process will remain as it is. However, if a jurisdiction has an open PI Waiver and is awarded a contract, going forward after the CDBG 2015 NOFA, the PI Waiver will need to be completed ***prior to*** drawing down grant funds.

However, grantees must have an approved Reuse Plan to expend PI and/or RLF monies if the grantee has no active CDBG contract.

NEW POLICY – Additional Considerations

Note: The Department reserves the right, for any significant on-going non-compliance with RLF and/or Program Income rules, to cancel any RLFs and require the funds, both RLF and PI, to be returned to the Department.

GENERAL ADMINISTRATION (GA)

As of July 1, 2014:

Grantee can carry forward the GA balance from Fiscal Year PI Report covering Fiscal Year 2013-2014. The balance forwarded will be used to determine the ***maximum available GA*** funding cap in the next step below.

For PI funds received after July 1, 2014, grantees may calculate 17% of PI received (again, excluding RLF monies). This amount can be added to the amount on hand as of July 1, 2014 and will be considered as part of the ***maximum available GA*** funding cap.

No Active Contract

The grantee can expend the funds calculated above, with an approved Reuse Plan, up to the established ***maximum available GA*** funding cap***,*** and may roll over this amount between fiscal years.

Active Contract

While grantees can continue to have a ***maximum available GA*** funding cap balance, they will not be able to "set-a-side" the funds as GA since PI must be used first. So that the grantee doesn't lose this calculated GA, the Department will increase the grant GA when PI Waivers (being added to 2012-2014 contracts) and Supplemental Activities are approved.

While the grantee may continue to maintain a ***maximum available GA*** funding cap with active contracts, these funds may not be set aside to remain on hand given that all PI must be spent first.

Note: Planning (PTA) Studies cannot be funded with PI GA, Supplemental Activities or Waivers, because Planning and Technical Assistance (PTA) funding is included in the federal 20% Administration Cap and must meet a National Objective to be eligible. Thus, PTA studies can only be done through an awarded contract.

AGREEMENTS BETWEEN THE STATE AND THE GRANTEE

Per the CDBG Final Rule, no funds (PI, RLF or grant funds) may be spent unless an agreement (contract) has been established and executed. All PI Reuse Plans, effective immediately, must be voided since they are not in compliance with HUD PI and RLF rules. The following actions are being implemented to permit the expenditure of PI and RLF monies.

- For grantees amending 2012 and 2013 contracts: with the addition of Waivers and/or Supplemental Activities, all PI and RLF rules and requirements will be added to the contract during the amendment process.

- For 2014 Contract and forward: all PI and RLF rules and requirements will be included prior to contract execution.

- For jurisdictions with no Active Contracts: the Department will make available an updated PI Reuse Plan by July 30, 2014, which must be fully executed in order to spend any PI or RLF monies outside of an Active Contract.

CITIZEN PARTICIPATION

Federal regulations require grantees to address all projected activities for the upcoming NOFA application submission during the pre-submission Public Hearing. This includes all grant funded activities and PI/RLF activities and expenditures. All Public Notices and Agendas for the hearings must include PI and RLF proposed activities and expenditures, in addition to all proposed grant and Supplemental activities.

- For active 2012, 13 and 14 contracts where Waivers and Supplemental Activities will be added/included, a separate Public Hearing must be held for the projected activities and expenditures being added to the contract, and documentation of such must be submitted to the Department to complete the contract amendment process.

- Beginning with the 2015 NOFA and going forward, the pre-application submission Public Hearing must include all proposed activities and expenditures including grant funded activities, PI and RLF activities, and Supplemental Activities.

PROGRAM INCOME REPORTING

For fiscal 2013/14, the current PI Report Form, along with Grant Performance Reports (GPR) must be used. The reporting changes reflected in this memo will begin concurrent with the 2014/15 fiscal year.

The current PI Report Form will be used to close out this fiscal year (2013/14), along with a GPR that reports the PI/RLF accomplishments.

Beginning with fiscal 2014/15 new Setup/Completion Reports will be incorporated into the PI/RLF and Grant reporting requirements, as well as into the 2014 Standard Agreement. A Management Memo will be released separately on this subject in the near future.

All of the above will be will be addressed in trainings.

NEW POLICY – Jurisdictions Leaving or Entering the State CDBG Program with Program Income

Pursuant to 24 CFR 570.489(e)(3)(iii) and (iv) the Department is implementing the following policy and procedures for jurisdictions that have State CDBG PI.

24 CFR 570.489(e)(3)(iii) ***Transfer of program income to Entitlement program.***

Jurisdictions that are entitlement communities or part of an urban agreement, or grantees that at a later date become an entitlement community or join a urban agreement, have the following options for PI and RLFs:

PI not associated with a RLF, the jurisdiction must:

1. Complete the process to certify they will be reporting the State PI into the Entitlement Programs process, including receipting the CDBG proceeds into IDIS, or,

2. Return all State CDBG Program Income to the Department, the amounts on hand as of July 1, 2014 and as it is received until all PI generated by State CDBG funding has been returned.

PI in an approved RLF:

Entitlement jurisdictions and those who are part of an urban agreement may keep their RLF(s) and monies within an RLF as long as the following is met:

1. They have a State Reuse Plan (agreement) signed by the Department and the City/County Authorized Representative.

2. Agree to immediately implement the RLF rules within this Memo and execute updated the Reuse Plan, as provided by the Department.

Note: the above must be complete prior to October 31, 2014 or all funds on-hand and within the loan portfolio that is from State CDBG activities will be consider PI and must be returned to the Department.

24 CFR 570.489(e)(3) (iv) ***Transfer of program income of grantees losing Entitlement status.***

Upon entry into the State CDBG program, a unit of general local government that has lost or relinquished its Entitlement status must submit a letter to the department, signed by the Authorized Representative stating which of the following options the jurisdiction will be implementing. Keep in mind, that retaining Entitlement PI while participating in the State CDBG program will require PI reporting for both sets of funding. Entitlement PI and any PI generated by State CDBG fund cannot be comingled.

Within 90 days of leaving the Entitlement Program to join the State CDBG program, the jurisdiction must certify that it will either:

1. Retain program income generated under Entitlement grants and continue to comply with Entitlement program requirements for program income, including reporting it into IDIS or the urban county; or

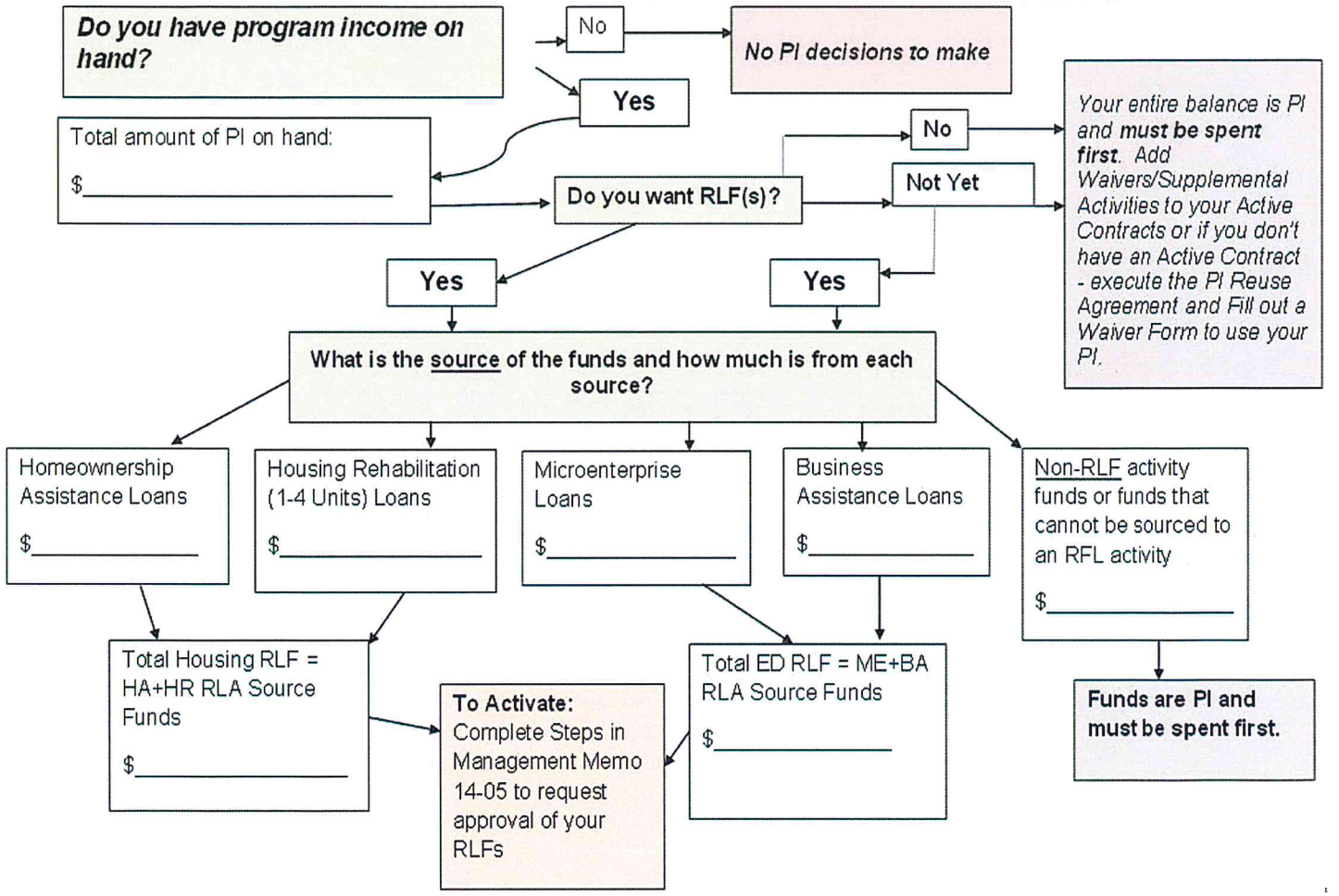
2. Retain the program income and transfer it to the State CDBG program, in which case the jurisdiction must comply with the State's rules for PI and RLF address within this Memo, the Reuse Plan and Chapter 14 of the Grant Management Memo.

Establishing a RLF Decision Flow

Decision Making

With a number of choices and decisions to make, the Department has a one page document that allows grantees to walk through the process. Please see Establishing a RLF Decision Flow, below.

Additionally, it is recommended that grantees contact the CDBG Representative with any questions regarding their particular circumstances:

http://www.hcd.ca.gov/fa/cdbg/ContactUs.html

ESTABLISHING A REVOLVING LOAN FUND - DECISION FLOW CHART